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SMALL BUSINESS LENDING

FIELD HEARING

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

HEARING HELD IN PHOENIX, ARIZONA, APRIL 27, 2010

Printed for the use of the Congressional Oversight Panel

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CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

ELIZABETH WARREN, *Chair*

PAUL ATKINS

J. MARK MCWATTERS

RICHARD H. NEIMAN

DAMON SILVERS

CONTENTS

	Page
Opening Statement of Elizabeth Warren, Chair, Congressional Oversight Panel	1
Statement of Mr. J. Mark McWatters, Member, Congressional Oversight Panel	5
Statement of Mr. Damon Silvers, Member, Congressional Oversight Panel	10
Statement of Mr. Richard Neiman, Member, Congressional Oversight Panel	14
Statement of Robert Blaney, Arizona District Director, U.S. Small Business Administration	18
Statement of Stan Ivie, Regional Director, San Francisco, Federal Deposit Insurance Corporation	23
Statement of Cindy Anderson, CEO, Great Biz Plans	52
Statement of Candace Wiest, President and CEO, West Valley National Bank	59
Statement of Paul Smiley, President and CEO, Sonoran Technology	64
Statement of James H. Lundy, President and CEO, Alliance Bank of Arizona	68
Statement of Mary Darling, CEO, Darling Environmental and Surveying	75
Statement of Lynne B. Herndon, Phoenix City President, BBVA Compass	80

FIELD HEARING ON SMALL BUSINESS LENDING

TUESDAY, APRIL 27, 2010

U.S. CONGRESS,
CONGRESSIONAL OVERSIGHT PANEL,
Phoenix, AZ.

The Panel met, pursuant to notice, at 10:05 a.m., at the University of Arizona, Phoenix, Arizona, Elizabeth Warren, Chair of the Panel, presiding.

Present: Professor Elizabeth Warren [presiding], Mr. Damon Silvers, Mr. J. Mark McWatters, and Mr. Richard Neiman.

OPENING STATEMENT OF ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Chair WARREN. I now call to order this meeting of the Congressional Oversight Panel for the Troubled Asset Relief Program.

Good morning. My name is Elizabeth Warren. I am the Chair of the Congressional Oversight Panel. I would like to begin this morning by extending our sincere thanks to the City of Phoenix, the University of Arizona, Senator John McCain, Senator John Kyl, and Congressman Ed Pastor for hosting us and for helping to plan today's hearing.

These hearings take a lot of people and a lot of moving parts and we're very grateful for the help of the congressional delegation.

Congress established our panel in October of 2008 to oversee the expenditure of the $700 billion Troubled Asset Relief Program, commonly called TARP. We issue monthly oversight reports that analyze and evaluate the Treasury's administration of this program in stabilizing our economy.

In the course of our work, we travel from time to time to areas of the country that have been especially hard hit by the financial crisis. This morning we're pleased to be in Phoenix to learn more about the credit crunch or the reduction of availability of credit for small businesses.

Oversight of this topic is a crucial role for our panel. The Secretary of the Treasury recently designated small business credit as one of the primary focuses of the TARP and he pledged TARP funds for additional efforts to facilitate small business lending.

This is a difficult moment for most American businesses, large and small. Companies of all sizes remain constrained by the recession, hampered by the unwillingness of banks to lend and weakened by the reluctance of customers to buy, but as our economic cycle turns towards recovery, there is a very real fear that, while

big businesses might be able to gain credit through Wall Street or the debt markets, small businesses will be left behind.

For Arizona this is not an acceptable outcome. Over 97 percent of the state's employers have fewer than 500 employees. Nearly half of the state's workers are employed by small businesses. A recovery that leaves behind Arizona's small businesses can hardly be termed a recovery at all.

Before the crisis, entrepreneurs who needed money to finance their business had many options. They could reach out to a local or a national bank and ask for a loan. They could charge expenses to a business credit card. They could contract with a non-bank lender to receive upfront payment on future income. They could take out an equity line of credit against their business property or their homes.

Today most of those choices have disappeared and for most businesses the only credit option remaining is a small business loan. But for even this, the pathway is restricted. Most banks have suffered severe losses and many have cut back on lending.

To make matters worse, the hardest-hit banks tend to be the smaller ones, the same institutions that disproportionately serve small businesses. The result could be a vicious cycle. Small businesses could find that because they cannot access credit, they cannot meet demand for their services. Their bottom line could suffer, further undermining the economy which in turn could further damage credit access. Breaking this cycle will be an important step toward economic recovery.

[The prepared statement of Ms. Warren follows:]

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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Elizabeth Warren

Congressional Oversight Panel Field Hearing on Small Business Lending

Phoenix, Arizona
April 27, 2010

Good morning. My name is Elizabeth Warren, and I am the Chair of the Congressional Oversight Panel. I would like to begin by extending our sincere thanks to the City of Phoenix, the University of Arizona, Senator John McCain, Senator Jon Kyl, and Congressman Ed Pastor for hosting us and for helping to plan today's hearing.

Congress established our Panel in October of 2008 to oversee the expenditure of funds from the $700 billion Troubled Asset Relief Program, commonly called the TARP. We issue monthly oversight reports that analyze and evaluate the Treasury's administration of this program and its results in stabilizing our economy.

In the course of our work, we travel from time to time to areas of the country that have been especially hard-hit by aspects of the financial crisis. This morning, we are pleased to be in Phoenix to learn more about the credit crunch or reduction in the availability of credit for small businesses. Oversight of this topic is a crucial role of our panel. The Secretary of the Treasury recently designated small business credit as one of the primary focuses of TARP, and he pledged TARP funds "for additional efforts to facilitate small business lending."

This is a difficult moment for most American businesses, large and small. Companies of all sizes remain strained by the recession, hampered by the unwillingness of banks to lend, and weakened by the reluctance of customers to buy. But as our economic cycle turns toward recovery, there is a very real fear that, while big businesses might be able to gain credit through Wall Street or the debt markets, small businesses could be left behind.

For Arizona, this is not an acceptable outcome. Over 97 percent of the state's employers have fewer than 500 employees. Nearly half of the state's workers are employed by small businesses. A recovery that leaves behind Arizona's small businesses can hardly be termed a recovery at all.

Congressional Oversight Panel

Before the crisis, entrepreneurs who needed money to finance their businesses had many options. They could reach out to a local or national bank to ask for a loan. They could charge expenses to a small business credit card. They could contract with a non-bank lender to receive upfront payment on future income. They could take out an equity line of credit on their home or on a business property.

Today, most of those choices have disappeared, and for most small businesses the only credit option remaining is a bank loan. But even this pathway is restricted. Most banks have suffered severe losses, and many have cut back on lending. To make matters worse, the hardest-hit banks tend to be smaller ones – the same institutions that disproportionately serve small businesses.

The result could be a vicious cycle. Small businesses could find that, because they cannot access credit, they cannot meet demand for their services. Their bottom line could suffer, further undermining the economy, which in turn could further damage credit access. Breaking this cycle will be an important step toward economic recovery.

We are grateful today to be joined by bankers, small business owners, and government witnesses who can speak firsthand to conditions facing banks and small businesses. We will hear from Robert J. Blaney, Arizona District Director of the Small Business Administration; Stan Ivie, San Francisco Regional Director of the Federal Deposit Insurance Corporation; Candace Wiest, President and CEO of West Valley National Bank; Lynne Herndon, City President in Phoenix for BBVA Compass Bank; James Lundy, President and CEO of Alliance Bank of Arizona; Mary Darling, CEO of Darling Environmental and Surveying, Inc.; Cindy Anderson, CEO of Great Biz Plans; and Paul Smiley, President of Sonoran Technology and Professional Services. We are also honored by the presence of Phoenix Mayor Phil Gordon. We thank all of you for your willingness to share your perspectives, and we look forward to hearing from you.

Chair WARREN. We are grateful today for all of our witnesses and I'll introduce them as we go along. And with that, I'm going to pause and ask for an opening statement from McWatters.

Mr. McWatters.

STATEMENT OF J. MARK McWATTERS, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. MCWATTERS. Thank you, Professor Warren. I very much appreciate the attendance of the distinguished witnesses, and I look forward to hearing their views.

The problems presented by today's commercial credit and small business lending markets would be easier to address if they were solely based upon the mere under-supply of commercial and small business credit in certain well-defined regions of the country.

Unfortunately, the commercial credit and small business lending markets must also assimilate a remarkable drop in demand from borrowers who have suffered reversals in their business operations and prospects over the past two years.

In my view, there has been a material decrease in demand for commercial and small business credit and many potential borrowers have withdrawn from the market due to, among other reasons, their desire to deleverage, the introduction of enhanced underwriting standards by lenders and their regulators, the diminishing opportunities for prudent business expansion, the crippling effects of the recession, and the increasing tax and regulatory burden facing small and large businesses.

Conversely, the Administration has focused on the undersupply of commercial and small business credit and has, not surprisingly, proposed a government-sponsored program to remedy the problem. If enacted as proposed, the Small Business Lending Fund will permit a subset of commercial and small business lenders to obtain capital from the Federal Government at very favorable rates, provided the lenders agree to use the proceeds to extend credit to small business borrowers.

In addition to serving as arguably the first step in a program to nationalize small business lending, I am troubled that providing financial institutions with capital at below market rates will lead to a prudent lending activity in the inflation of a series of government-sanctioned and subsidized asset bubbles.

If the Government convinces or pressures financial institutions to accept cheap credit, based on the condition that the recipients offlend the proceeds, then I suspect the Government will accomplish just that. Yet isn't this what we have just recently experienced in the sub-prime credit bubble? Too much money chasing transactions of diminishing credit quality.

The Administration's proposal appears to share much of the business model with those adopted by Fannie Mae and Freddie Mac. Treasury should have learned from Fannie and Freddie that the combination of below market credit, together with a single-minded mandate to lend, regardless of credible demand, serves as a perfect recipe for the creation of asset bubbles.

In addition, the Administration's program seems at cross purposes with the recent actions of federal banking regulators who have become increasingly cautious, perhaps even overly cautious,

regarding extensions of credit and renewals by regulated financial institutions.

It is indeed ironic for the Administration to propose a program of cheap credit-driven lending while at the same time federal and state banking regulators are attempting to reign in the excesses that inevitably followed from the Government's last experiment with cheap credit.

Instead of requiring the taxpayers to subsidize another round of imprudent short-term credit expansion, commercial and small business lenders, in consultation with the regulators, where appropriate, should adopt long-term business models and strategies that incorporate objective and transparent due diligence standards that permit well-run borrowers to receive credit on reasonable terms and lenders to earn an appropriate risk-adjusted rate of return.

Regrettably, some potential borrowers will fail the heightened underwriting standards and will not receive the requested extensions of credit. This should not necessarily serve as a sign of angst but should indicate that the credit markets have moved away from an anything goes mentality where borrowers frequently overextended their leverage and financial institutions survived through the clever interpretation of accounting rules and the implicit guarantee of their obligations by the American taxpayers.

Any suggested solution to the challenges facing commercial credit and small business lenders and borrowers that focuses only on the undersupply of credit to the exclusion of the economic difficulties facing prospective borrowers appears unlikely to succeed. Until small and large businesses regain the confidence to hire new employees and expand their business operations, it is doubtful that the demand for properly-underwritten commercial and small business credit will sustain a meaningful recovery.

As long as business persons are faced with the multiple challenges of rising taxes and increasing regulatory burdens, it is unlikely that they will enthusiastically assume the entrepreneurial risk necessary for protracted economic expansion and a recovery of the commercial credit and small lending markets.

Thank you for joining us today. I look forward to our discussion.

[The prepared statement of Mr. McWatters follows:]

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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of J. Mark McWatters

Congressional Oversight Panel Field Hearing on Small Business Lending

April 27, 2010

Thank you Professor Warren.

I very much appreciate the attendance of the distinguished witnesses and I look forward to hearing their views.

In order to suggest a solution to the challenges currently facing the commercial credit and small business lending markets it is critical that we thoughtfully identify the sources of the underlying difficulties. Without a proper diagnosis it is likely that we may craft an inappropriately targeted remedy with adverse unintended consequences.

The problems presented by today's commercial credit and small business lending markets would be easier to address if they were solely based upon the mere undersupply of commercial and small business credit in certain well defined regions of the country. Unfortunately, the commercial credit and small business lending markets must also assimilate a remarkable drop in demand from borrowers who have suffered a reversal in their business operations and prospects over the past two years. In my view, there has been a material decrease in demand for commercial and small business credit and many potential borrowers have withdrawn from the markets due to, among other reasons (i) their desire to de-leverage, (ii) the introduction of enhanced underwriting standards by lenders and their regulators, (iii) the diminishing opportunity for prudent business expansion, (iv) the crippling effects of the recession, and (v) the increasing tax and regulatory burdens facing small and large businesses.

Conversely, the Administration has focused on the undersupply of commercial and small business credit and has, not surprisingly, proposed a government-sponsored program to remedy the problem. If enacted as proposed, the Small Business Lending Fund (SBLF) will permit a subset of commercial and small business lenders to obtain capital from the Federal government at very favorable rates provided the lenders agree to use the proceeds to extend credit to small business borrowers. In addition to serving as arguably the first step in a program to nationalize small business lending, I am troubled that providing financial institutions with capital at below market rates will lead to imprudent lending activity and the inflation of a series of government sanctioned and subsidized asset bubbles. If the government convinces—or pressures—financial institutions to accept cheap credit based on the condition that the recipients off-lend the proceeds

then I suspect the government will accomplish just that. Yet, isn't this what we have recently experienced in the sub-prime credit bubble—too much money chasing transactions of diminishing credit quality?

The Administration's proposal appears to share much of its business model with those adopted by Fannie Mae and Freddie Mac. Treasury should have learned from Fannie and Freddie that the combination of below market credit together with a single-minded mandate to lend—regardless of credible demand—serves as the perfect recipe for the creation and implosion of asset bubbles. In addition, the Administration's program seems at cross-purposes with the recent actions of Federal banking regulators who have become increasing cautious—perhaps overly cautious—regarding extensions and renewals of credit by regulated financial institutions. It is indeed ironic for the Administration to propose a program of cheap credit driven lending while at the same time Federal and state banking regulators are attempting to reign in the excesses that inevitably followed from the government's last experiment with cheap credit.

Instead of requiring the taxpayers to subsidize another round of imprudent short-term credit expansion, commercial and small business lenders—in consultation with their regulators where appropriate—should adopt long-term business models and strategies that incorporate objective and transparent due diligence standards that permit well run borrowers to receive credit on reasonable terms and the lenders to earn an appropriate risk adjusted rate of return. Regrettably, some potential borrowers will fail the heightened underwriting standards and will not receive their requested extensions of credit. This should not necessarily serve as a sign of angst but should indicate that the credit markets have moved away from an "anything-goes" mentality where borrowers frequently over-extended their leverage and financial institutions survived through the clever interpretation of accounting rules and the implicit guarantee of their obligations by the American taxpayers.

Any suggested solution to the challenges facing commercial credit and small business lenders and borrowers that focuses only on the undersupply of credit to the exclusion of the economic difficulties facing prospective borrowers appears unlikely to succeed. The challenges confronting the commercial credit and small business lending markets are not unique to that industry, but, instead, are indicative of the systemic uncertainties manifest throughout the larger economy. Until small and large businesses regain the confidence to hire new employees and expand their business operations it is doubtful that the demand for properly underwritten commercial and small business credit will sustain a meaningful recovery. As long as businesspersons are faced with the multiple challenges of rising taxes, increasing regulatory burdens, enhanced political risk associated with unpredictable governmental interventions in the private sector as well as uncertain health care and energy costs, it is unlikely that they will enthusiastically assume the entrepreneurial risk necessary for protracted economic expansion and a recovery of the commercial credit and small business lending markets. With the ever expanding array of less than friendly rules, regulations and taxes facing businesspersons and consumers we should not be surprised if businesses remain reluctant to hire new employees,

consumers remain cautious about spending, and the commercial credit and small business lending markets continue to struggle.

In my view, the Administration could jump start the prompt and robust recovery of the commercial credit and small business lending markets--as well as the overall U.S. economy--by sending an unambiguous message to the private sector that it will not directly or indirectly raise the taxes or increase the regulatory burden of commercial credit and small business market participants and other business enterprises. Without such express action, the recovery of the commercial credit and small business lending markets will most likely proceed at a sluggish and costly pace.

Thank you for joining us today and I look forward to our discussion.

Chair WARREN. Thank you, Mr. McWatters.

Mr. Silvers.

STATEMENT OF DAMON SILVERS, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Thank you, Chair Warren. Good morning.

This hearing is an effort by our panel to learn more about the circumstances of small- and medium-sized businesses seeking to obtain credit and, in particular, to learn whether TARP, the federal bank bailout, has been successful in its purpose of ensuring the flow of credit to Main Street.

Like my fellow panelists, I want to express my appreciation to our staff, to the University of Arizona for this facility, to the state's congressional delegation and the Mayor of Phoenix for their assistance with this hearing.

Arizona has been particularly hard hit by the financial and economic crisis that began in 2007. Unemployment in this state is at 9.6 percent officially. There's testimony from one of the witnesses that the real rate in the Phoenix area may be something like 15 percent and housing prices statewide have fallen by 36 percent.

Consequently, it is appropriate that our panel come here to learn about the state of credit provision to small- and medium-sized businesses.

Now, in coming here, we did not know that today Arizona would be the focus of a profound debate about our character as a nation, a debate with roots in the pain caused by the economic crisis, but since this debate is underway and we are here, I wish to say that for me America is a place where the police do not ask for your identity papers as you go about your business, and I hope we can soon say the same about Arizona.

We have banks in substantial part that transform our savings into credit for business. When then-Treasury Secretary Paulson went to Congress to create TARP, he spoke of the dire threat to the banking system as a whole with serious consequences for small- and medium-sized businesses throughout our country that depend on bank credit to finance inventory and capital goods, to purchase real estate, and the many other ways to keep operating and creating jobs.

What Secretary Paulson did not say, as far as I know, was that as a result of the concentration in the U.S. banking sector, small- and medium-sized businesses nationwide have depended increasingly on credit from large banks. The biggest banks, those with over a 100 billion in assets, provided only 15 percent of small business loans in 1999 while in 2008 those banks provided 37 percent.

Unfortunately, the largest 22 banks receiving TARP funds, none of which were allowed to fail in the financial crisis, have actually reduced business lending nationwide during the period from April to November 2009, a period when large banks were supposed to be recovering and recording very high profits. Meanwhile in Arizona, we have seen an epidemic of weakness among locally-based banks with 84 percent of the state's banks losing money in 2009 and six banks closed by the FDIC, an epidemic driven largely by residential and commercial real estate loan weakness.

Economic recovery and job creation require that our banking sector do its job by providing credit on reasonable terms to creditworthy borrowers. I hope we can learn today about the roles played by locally-based and national banks in credit provision in Arizona and get a sense of the relative importance of the weakness of borrowers versus the weakness of lenders in the contraction in bank lending to small business and in understanding the decline of lending to small- and medium-sized businesses as a result of the economic crisis.

Finally, I've long suspected that despite the TARP, our banks, both large and small, continue to be under-capitalized. In this environment and so long as banks are not sufficiently recapitalized or restructured, there is reason to believe that bank capital structures will not work to channel credit to small business, much as the TARP seems not to have done so during 2009.

I would be interested in today's witnesses' thoughts on how to channel credit to small business borrowers prudently in this environment and, in particular, whether TARP monies should be channeled directly to small- and medium-sized business lending, much as TARP money and Federal Reserve money has been used to directly support Wall Street-oriented credit markets, such as the asset-backed securities markets through the TALF and PPIP Programs.

Thank you, and I look forward to hearing from our witnesses.

[The prepared statement of Mr. Silvers follows:]

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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Damon Silvers

Congressional Oversight Panel Field Hearing on Small Business Lending

April 27, 2010

Good morning. This hearing is an effort by our Panel to learn more about the circumstances of small and medium sized businesses seeking to obtain credit, and in particular to learn whether TARP, the federal bank bailout, has been successful in its purpose of ensuring the flow of credit to Main Street. Like my fellow panelists, I want to express my appreciation to our staff and to Arizona's Congressional delegation and the Mayor of Phoenix for their assistance with this hearing.

Arizona has been particularly hard hit by the financial and economic crisis that began in 2007. Unemployment is at 9.6% and housing prices statewide have fallen by 36%. Consequently, it is appropriate our Panel come here to learn about the state of credit provision to small and medium sized business. We did not know when we planned this hearing that today Arizona would be the focus of a profound debate about our character as a nation, a debate with roots in the pain caused by the economic crisis. But since this debate is underway, I wish to say that for me, America is a place where the police do not ask for your identity papers as you go about your business. I hope we can soon say the same about Arizona.

We have banks in substantial part to transform our savings into credit for business. When then Treasury Secretary Paulsen went to Congress to create TARP, he spoke of the dire threat to the banking system as a whole, with serious consequences for small and medium sized businesses throughout our country that depended on bank credit to finance inventory and capital goods, to purchase real estate, and in many other ways, to keep operating and creating jobs.

What Secretary Paulsen did not say was that as a result of the concentration in the U.S. banking sector, small and medium businesses nationwide have depended increasingly on credit from large banks. The biggest banks, those with over $100 billion in assets, provided only 15% of small business loans in 1999, in 2008 those big banks provided 37% of small denomination business loans.

Unfortunately, the largest 22 banks receiving TARP Capital Purchase Plan funds—none of which were allowed to fail in the financial crisis, have actually reduced business lending nationally during the period from April to November, 2009—a period when large banks were supposed to be recovering and were recording very high profits. Meanwhile in Arizona, we have

seen an epidemic of weakness among locally based banks, with 84% of the state's banks losing money in 2009, and six banks closed by the FDIC—an epidemic driven largely by residential and commercial real estate loans.

Economic recovery and job creation requires that our banking sector do its job by providing credit on reasonable terms to creditworthy borrowers. I hope we can learn today about the roles played by locally based and national banks in credit provision in Arizona, and get a sense of the relative importance of the weakness of borrowers vs. the weakness of lenders, banks, in understanding the decline of lending to small and medium sized business as a result of the economic crisis.

Finally, I have long suspected that despite TARP, our banks, both large and small, continue to be undercapitalized. In this environment, and so long as banks are not sufficiently recapitalized or restructured, there is reason to believe that bank capital structures will not work to channel credit to small business, much as the TARP seems not to have done so during 2009. I would be interested in the witnesses' thoughts on how to channel credit to borrowers prudently in this environment, and in particular whether TARP money should be channeled directly to small and medium sized business lending, much as TARP money and Federal Reserve money has been used to directly support Wall Street-oriented credit markets such as the asset backed securities markets through the TALF and PPIP programs.

Thank you and I look forward to hearing from our witnesses.

Chair WARREN. Thank you, Mr. Silvers.

Superintendent Neiman.

STATEMENT OF RICHARD NEIMAN, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. NEIMAN. Thank you. Good morning. I'm also very pleased to be here in Phoenix and to continue the Panel's commitment to issues around small business lending.

I especially want to thank the witnesses—both the small businesses and other consumers and borrowers—who are here, as well as the banks and regulatory officials.

I'd also like to thank the state's newly-appointed banking superintendent, Lauren Kingry, who is also in attendance here, and I know representing the Governor. So I very much appreciate your participation here today.

The spiraling financial crisis has touched every corner of the credit markets, including products like small business lending, which were seemingly remote from the sub-prime mortgages that were at the heart of the crisis.

Small businesses are engines of the economy and of job creation. The financial crisis and ensuing recession, however, have created a catch-22 that makes it difficult to restart the credit markets. There is a lack of confidence on both the supply and the demand side which reinforces this economic rut.

Small businesses are understandably hesitant to take on more debt and expand at a time when their own customer base may be less than stable and banks are also understandably reluctant to take on more risk at a time when small businesses may have strained income.

Community banks are frequent sources for small business credit, and, in this stage of the financial crisis, smaller banks are coming under increasing stress. We have seen growing numbers of smaller banks fail recently and anticipate that this trend will continue.

These small bank failures, which could be increasingly driven by commercial real estate defaults, create holes in our communities. Where there was once a flourishing center for responsible hometown lending, there can be a vacuum. This means less credit may be available for small businesses as well as for consumer lending.

So I see a clear connection between righting the ship for real estate loans and small business lending. Commercial real estate defaults may constrain the lending capacity of the smaller banks which provide credit to many small businesses and since many small businesses use their homes as business collateral, the cratering of the residential real estate market has reduced these borrowers' ability to qualify for loans.

To break the stalemate, we will require old-fashioned underwriting to identify the good deals that are still waiting to be made. It may also require banks to think not only creatively but collectively.

For example, we have a unique small business program in New York. It's centered on the New York Business Development Corporation which was chartered in the 1950s during a recessionary period, and to my knowledge we are one of the few such programs in the country.

This consortium is an entity which functions similar to a lending consortium. Member banks provide funding to the corporation which in turn makes loans to small businesses, loans that banks would typically decline.

The New York Business Development Corporation has had a very successful history with these loans and it's a real force for economic development in my state and I intend to explore the means of using TARP funds for similar small business lending consortiums during my question period.

It is my hope and intent that today's hearing will assess the magnitude of the problem in small business lending and, most importantly, explore potential market-based and public policy solutions.

I look forward to your testimony and to your innovative ideas. Thank you.

[The prepared statement of Mr. Neiman follows:]

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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Richard Neiman

Congressional Oversight Panel Field Hearing on Small Business Lending

April 27, 2010

Good morning. I am pleased to be here in Phoenix to continue the Panel's commitment to issues around small business lending. The spiraling financial crisis has touched every corner of the credit markets, including products like small business loans which were seemingly remote from subprime mortgages.

Small businesses are engines of the economy and of job creation. The financial crisis and ensuring recession, however, has created a catch-22 that makes it difficult to restart this credit market. There is a lack of confidence on both the supply and the demand side, which reinforces the economic rut.

- Small businesses are understandably hesitant to take on more debt and expand at a time when their own customer base may be less stable; and,
- Banks are also understandably reluctant to take on more risk at a time when small businesses may have strained income.

Community banks are frequent sources for small business credit, and in this stage of the financial crisis, smaller banks are coming under increasing stress. We have seen growing numbers of smaller banks fail recently, and anticipate this trend will continue. These small bank failures, which could be increasingly driven by commercial real estate defaults, create holes in our communities. Where there once was a flourishing center for responsible hometown lending, there can be a vacuum. This means less credit may be available for small businesses, as well as for consumer lending.

So I see a clear connection between righting the ship for real estate loans and small business lending. Commercial real estate defaults may constrain the lending capacity of the smaller banks which provide credit to many small businesses. And since many small businesses use their homes as business collateral, the cratering of the residential real estate market has reduced these borrowers' ability to qualify for a loan.

To break this stalemate will require old-fashioned underwriting, to identify the good deals that are still waiting to be made. It may also require banks to think not only creatively, but collectively.

For example, we have a unique small business program here in New York. It is centered on the New York Business Development Corp (NYBDC), which was chartered in the 1950's during a recessionary period. To my knowledge, we are one of the few such programs in the country, with New York's being particularly well established.

The NYBDC is an entity which functions similar to a lending consortium. Member banks provide funding to the NYBDC, which in turns makes loans to small businesses- loans that banks would typically decline. The NYBDC has had a very successful history with these loans, and is a real force for economic development within my state.

I see potential for this model as a means of using TARP or other federal funds to spur responsible small business lending, especially at a time when bank lending is declining. Banks that are risk-averse could still support small business lending, through the funding of similar collective enterprises.

It is my hope and intent that today's hearing will assess the magnitude of the problem in small business lending and, most importantly, explore potential market-based and public policy solutions.

I look forward to your testimony this morning, and to your innovative ideas.

Chair WARREN. Thank you, Superintendent Neiman. So now we will hear from Robert J. Blaney, the Arizona District Director of the Small Business Administration, and from Stan Ivie, San Francisco Regional Director of the Federal Deposit Insurance Corporation.

I would like to give each of you five minutes for an opening statement. Your entire written remarks will be put in the record, though. So don't feel constrained about that.

Mr. Blaney, could we start with you?

STATEMENT OF ROBERT BLANEY, ARIZONA DISTRICT DIRECTOR, U.S. SMALL BUSINESS ADMINISTRATION

Mr. BLANEY. Thank you. Thank you, Chair Warren and Members Neiman, Silvers, and McWatters.

My name is Robert Blaney. I am the District Director for the Small Business Administration or the SBA. I am honored to be testifying before you today on behalf of the SBA concerning current credit conditions for small businesses, especially those in Arizona.

One of the main missions of the SBA is to provide small business owners with access to much-needed capital. We do this primarily by providing a partial government guarantee on loans given by banks and other lending partners. This guarantee helps provide access to capital for creditworthy small businesses that would otherwise be unable to get loans.

Our programs help to support many small businesses and we understand the difficulties small businesses face with access to credit in today's economic climate. To address the financial crisis, Congress passed the Recovery Act which President Obama signed into law on February 17th, 2009. This legislation allowed the SBA to raise guarantees on eligible 7(a) loans to 90 percent and reduce or eliminate fees in our 7(a) and 504 loan programs.

As a result, while conventional lending to small businesses continues to lag, SBA lending nationwide has increased dramatically since the weeks before the Recovery Act was passed. Here in Arizona, SBA lending has increased by nearly 60 percent since the passage of the Act. Nationwide, we turned about $530 million in taxpayer funding into support for more than $25 billion in loans to small business owners which is a great bang for the taxpayers' buck. This includes nearly $530 million in SBA-supported loans to Arizona small businesses.

Despite these accomplishments, I know that times are still tough for small business owners. Given those ongoing difficulties, the SBA has worked with the President to create a jobs plan that targets the lending gaps that still exist. There are four components to this small business jobs agenda.

First, to address the issue of banks that still have trouble taking risk, we've asked for a temporary extension of the increased 90 percent guarantee and reduced fees.

Second, many small businesses, franchises, manufacturers, exporters, and others need bigger SBA loans to create jobs. Therefore, we want to permanently increase our top loan limits from $2 million to $5 million for 7(a) and $4 million to $5.5 million for our 504 loan program.

Third, for businesses that can't find access to working capital, we need to temporarily raise the SBA express loan limit from $350,000 to $1 million. These loans will help businesses restock shelves and fill orders coming in.

Fourth, we know that many small businesses have conventional owner-occupied commercial real estate mortgages that will need to be refinanced soon. As real estate values have declined, many banks will find that these businesses no longer qualify for conventional loans, regardless of the strength of the businesses.

As a result, even small businesses that are performing well and making their payments on time can have a hard time refinancing these loans and may face foreclosure.

Chair WARREN. Mr. Blaney, can I stop you there? That's five minutes. Thank you very much. We've all, I think, read your written testimony, and we'll make sure it's included in the record.

[The prepared statement of Mr. Blaney follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Testimony of
Robert Blaney
District Director
Arizona District Office
U.S. Small Business Administration

Before the
Congressional Oversight Panel
Field Hearing in Phoenix, Arizona

April 27, 2010

Thank you Chair Warren, and members Neiman, Silvers, Atkins, and McWatters. My name is Robert Blaney and I am the Arizona District Director for the Small Business Administration (SBA). I am honored to be testifying before you today on behalf of the SBA concerning current credit conditions for small businesses, especially those here in Arizona.

As you noted in your invitation letter, "the ability of small businesses to access affordable credit is critical to economic recovery and renewed job growth, particularly in Arizona where approximately 97 percent of the businesses in the state are considered small businesses." We at the SBA could not agree more. One of the main missions of the SBA is to provide small business owners with access to much needed capital. We do this primarily by providing a partial government guarantee on loans given by banks and other lending partners.

This guarantee helps provide access to capital for creditworthy small businesses that would otherwise be unable to get loans. As a result, we over-index in loans to women and minorities. Additionally, SBA has specialty programs for some small business owners, such as our Patriot Express program, for Veterans, and Community Express, for businesses in distressed and underserved communities.

Our programs help to support many small businesses. And we understand the difficulties small businesses face with access to credit in today's economic climate.

To address the financial crisis, Congress passed the Recovery Act, which President Obama signed into law on February 17, 2009. This legislation allowed the SBA to raise guarantees on eligible 7(a) loans to 90% and reduce or eliminate fees in our 7(a) and 504 loan programs.

The raised guarantee provided an extra incentive for risk-averse lenders to lend to small businesses. The fee reductions made the loans more appealing to borrowers, and put more money in the hands of small business owners who need it.

As a result, while conventional lending to small businesses continues to lag, SBA lending nationwide has increased dramatically since the weeks before the Recovery Act was passed. Here in Arizona SBA lending has increased by nearly 60% since the passage of the Act.

Nationwide, we've turned about $530 million in taxpayer funding into support for more than $25 billion in loans to small business owners – which is a great bang for the taxpayer's buck. This includes nearly $530 million in SBA-supported loans to Arizona-based small businesses

Despite these accomplishments, I know that times are still tough for small business owners. While SBA's Recovery loans are helping, it's clear that many small business owners are still having a hard time getting access to credit. Declines in home values have hurt small business owners as well, because many entrepreneurs used home equity to finance their business. We know that there is still more work to do.

At SBA, we have identified several key problems that have contributed to the "lending gap" that remains between creditworthy small businesses and the financing that lenders are currently making available through conventional loans. We recognize that initiatives are needed that will address banks' capital constraints and decreased risk tolerance. After we examined how to use our programs to address demand for credit, availability of capital, and risk tolerance, the SBA worked with the President to create a jobs plan that targets the gaps that still exist. The proposals contained in this "small business jobs agenda" are aimed at increasing small business lending and putting more capital in the hands of small businesses to help them not only stabilize, but also expand and create jobs.

As outlined by the President in his State of the Union address earlier this year, there are 4 key components of this "small business jobs agenda":

1. First, to address the issue of banks that still have trouble taking risk, we've asked for a temporary extension of the increased 90% guarantee and reduced fees.

2. Second, many small businesses – franchisees, manufacturers, exporters, and others – need bigger SBA loans to create jobs. Therefore, we want to permanently increase our top loan limits from $2 million to $5 million for 7(a) and $4 to $5.5 million for our 504 program.

3. Third, for businesses that can't find access to working capital, we need to temporarily raise the SBA Express loan limit from $350,000 to $1 million. These loans will help businesses restock shelves and fill orders coming in.

4. Fourth, we know that many small businesses have conventional, owner-occupied commercial real estate mortgages that will need to be refinanced soon. As real estate values have

declined, many banks will find that these businesses no longer qualify for conventional loans, regardless of the strength of the businesses. As a result, even small businesses that are performing well and making their payments on time can have a hard time refinancing these loans and may face foreclosure.

5. So, we want to temporarily open up SBA's 504 program to owner-occupied commercial real estate refinancing. It's critically important that we prevent creditworthy firms here in Arizona and across the country from facing unnecessary foreclosure and lost jobs. 504 refinancing will allow them to lock in stable, long-term financing, while freeing up banks to make even more small business loans.

This plan is guided by basic principles: build on what works, maximize limited taxpayer dollars, and make targeted changes as quickly as possible. It addresses specific gaps in demand, availability of credit, and risk tolerance. As we continue to work with Congress to implement this "small business jobs agenda" through the legislative process, the SBA is confident that this plan will allow us to continue to help small businesses in this tough economic climate.

We want to build on the success of the Recovery Act by expanding points of access and bringing more small businesses into a long-term banking relationship with an SBA lender. And we want to increase the number of banks that offer SBA products. Our field staff, here in Arizona and across the country, are working to sign up more lenders.

Let me close by saying that the SBA is here to help small businesses. Our field staff and resource partners are standing by to help small business owners and entrepreneurs as they start and grow their business. Small business owners here in Arizona have access to:

- Our Arizona District Office here in Phoenix, as well as our offices in Tucson and Show Low
- 18 Small Business Development Centers throughout the state
- Our Women's Business Center in Tucson, our national award winning veteran's service officer who covers all of Arizona, and
- Three chapters of SCORE, our executive mentoring service that counsels in 23 locations throughout Arizona

I want to thank you all for holding this hearing to highlight both the current credit conditions for small businesses as well as efforts by government agencies such as the SBA to get them the support they need. I am now happy to discuss any of the SBA's proposals and answer any questions.

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Chair WARREN. Mr. Ivie.

STATEMENT OF STAN IVIE, REGIONAL DIRECTOR, SAN FRANCISCO FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. IVIE. Thank you, Chair Warren and members of the Congressional Oversight Panel.

I'm Stan Ivie, Regional Director for the FDIC's San Francisco Region which covers 11 Western states, including Arizona.

I appreciate the opportunity to testify today on behalf of the FDIC on the state of bank lending and access to credit for small businesses.

The FDIC is the federal insurer of deposits at all banks and thrifts and serves as the primary federal supervisor for more than 5,000 state-chartered banks. We work closely with state regulatory authorities in performing our supervisory duties and understand the challenges faced by financial institutions and their customers during these difficult economic times.

Bankers and examiners know that responsible lending is good business and benefits everyone. We also know that continued recovery of our economy will depend heavily on creditworthy borrowers having access to credit at our nation's insured banks.

The ailing economy has stressed the balance sheets of both banks and small businesses, creating a difficult credit environment at both banks and small businesses. The rapid deterioration has resulted in declines in both the demand for and supply of credit.

Nationwide, expenses for troubled loans continue to weigh heavily on our banks. More than half of the banks in the West are not currently profitable, as costs associated with charged-off loans and provisions to increase reserves for loan and lease losses continue to negatively impact earnings.

Non-current loans more than 90 days past due or on non-accrual represented 5.37 percent of all bank loans at year-end 2009, a 26-year high. The rate of increase in the volume of non-current loans, however, has slowed for three consecutive quarters and we expect that trend to continue.

Arizona's banks and small businesses have been particularly hard hit by the recent economic downturn. 2009 was a particularly difficult year for Arizona banks as the state's institutions charged off loans and reserves for future loan losses at record high levels, resulting in the second lowest median pre-tax return on assets, ROA, in the nation.

Small businesses have also been severely impacted by the economic downturn. While surveys clearly reflect that bank loans have become more difficult to obtain, their own deteriorating business conditions appear to represent an even bigger problem as many cite poor sales as their biggest business problem.

Bank examiners at the FDIC recognize the critical role that banks and small businesses play in our economy. Our examiners work out of 85 local duty stations and communities located across the country, including one right here in Phoenix. They are experienced, professional, and knowledgeable about their banks and local market conditions.

FDIC examiners are not directly involved in a bank's credit decisions. The FDIC provides banks with considerable flexibility in

dealing with their customers and managing loan portfolios. We do not instruct banks to curtail prudently-managed lending activities, restrict lines of credit to strong borrowers or deny renewal requests solely because of weakened collateral value. We do not require new appraisals for a healthy loan that is performing according to its original terms.

We leave the business of lending to those who know it best, the community bankers who provide credit every day to small businesses and consumers throughout America and here in Arizona.

To ensure consistency in our approach, FDIC employees at headquarters, in the region and in the field are engaged in a continuous and ongoing dialogue about credit conditions and our supervisory approach. We also communicate regularly with other federal and state regulators and hold roundtable discussions with local bankers to gain their perspective.

We emphasize that our examiners should take a balanced approach and that they should encourage banks to originate and renew properly-underwritten real estate, commercial, and consumer loans and to work with borrowers facing difficulties to restructure their obligations.

In determining what is a performing loan, FDIC examiners focus on borrower cash flow as a primary source of repayment. Collateral support serves as a secondary source of repayment. When reviewing loans, we look at collateral documentation but focus on the borrower's overall financial strength, including guarantor support and business cash flow projections. A borrower's willingness and ability to keep payments current, especially during stressed economic times, is a primary factor in evaluating loans.

The FDIC has issued a series of statements to clarify our supervisory processes and to encourage financial institutions to make prudent loans. Most recently, on February 12th, 2010, regulators jointly issued the Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers to encourage prudent lending and emphasize that examiners will apply a balanced approach in evaluating small business loans.

In conclusion, while many challenges remain before bankers, small businesses, consumers, and regulators, the FDIC is confident that the banking industry as a whole is moving in the right direction toward more sound lending practices, stronger balance sheets, and a greater capacity to serve the credit needs of small businesses and their communities.

Thank you.

[The prepared statement of Mr. Ivie follows:]

STATEMENT OF

STAN IVIE
REGIONAL DIRECTOR, SAN FRANCISCO
FEDERAL DEPOSIT INSURANCE CORPORATION

on

SMALL BUSINESS CREDIT AND LENDING

before the

CONGRESSIONAL OVERSIGHT PANEL

April 27, 2010

Phoenix, Arizona

Chair Warren and Members of the Congressional Oversight Panel, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on the state of lending and credit availability for small business. As the Regional Director for the FDIC's San Francisco region, I am responsible for overseeing bank supervision, regulation, safety and soundness examinations and consumer compliance examinations in 11 western states, including Arizona.

In my testimony, I will briefly describe the quality of loan portfolios at FDIC-insured institutions, nationwide trends in the availability of credit, and conditions currently creating obstacles to credit availability. I also will address the credit conditions in Arizona. Finally, I will discuss concerns that banks are receiving mixed messages from their supervisors and the efforts the FDIC is making to encourage prudent lending by the institutions we supervise.

Credit Quality and Lending Activity

As federal insurer for all banks and thrifts, and primary federal supervisor for just over 5,000 state chartered banks, the FDIC is very aware of the challenges faced by financial institutions and their customers during these difficult economic times. Among the greatest strengths of our economy is the diverse collection of over 8,000 FDIC-insured depository institutions that operate almost 100,000 offices in every corner of our nation. Bankers and examiners know that prudent, responsible lending is good business and benefits everyone.

Adverse credit conditions brought on by an ailing economy and stressed balance sheets, however, have created a difficult environment for both borrowers and lenders. The deterioration in the economy contributed to a decline in both the demand and the supply of credit. Continued resolution of the current economic crisis will depend heavily on creditworthy borrowers, both consumer and business, having access to lending.

Nationwide, expenses for troubled loans continue to weigh heavily on insured depository institutions. The industry earned less than $1 billion in the fourth quarter of 2009, essentially just breaking even. During the quarter, insured institutions added $61.1 billion in provisions for loan and lease losses to their reserves, although this was $10 billion less (-14.1 percent) than they set aside in the fourth quarter of 2008. Net charge-offs of loans and leases totaled $53 billion, an increase of $14.4 billion (37.2 percent) compared to a year earlier. The annualized net charge-off rate in the quarter was 2.89 percent, which is the highest rate in any quarter in the 26 years for which quarterly charge-off data are available. The amount of loans and leases remaining on banks' balance sheets that were noncurrent rose by $24.3 billion (6.6 percent) during the quarter.[1] At the end of December, 5.37 percent of all loans and leases were noncurrent. This also represents a 26-year high. However, fourth quarter 2009 was the third consecutive quarter that the rate of increase in the volume of noncurrent loans slowed.

Major loan categories exhibited high levels of charge-offs and noncurrent loans. The highest net charge-off rates in the fourth quarter were for credit cards (9.16 percent

[1] Noncurrent loans are those that are 90 days or more past due or on nonaccrual status.

annualized) and real estate construction and development loans (7.77 percent). The net charge-off rate for real estate construction and development loans represented a record high and the net charge-off rate for credit card loans is near the record high set last quarter. Construction and development loans also had the highest noncurrent rate at the end of December (15.95 percent), followed by 1-4 family residential mortgage loans (9.31 percent), both record high levels.

Larger institutions had higher charge-off and noncurrent rates than smaller institutions. The average net charge-off rate on all loans and leases for community banks (institutions with less than $1 billion in assets) was 1.70 percent in the quarter, compared to an average of 3.09 percent at larger institutions. The ratio of noncurrent loans and leases to total loans and leases for community banks as of December 31 was 3.43 percent, versus 5.68 percent for larger institutions. Some of the difference in credit quality performance reflects differences in the composition of loan portfolios at large and small banks. Large institutions have higher proportions of retail loans (residential mortgages and consumer loans) while community banks have larger relative shares of loans to commercial borrowers. Consequently, the negative impact of falling housing prices and rising unemployment and bankruptcies has been greater in the loan portfolios of large banks. Further deterioration in commercial real estate (CRE) markets would have a greater proportional impact on the performance of small and medium-sized institutions.

Tighter underwriting standards, deleveraging by institutions seeking to improve their capital ratios, and slack loan demand have all contributed to declines in loan

balances at many institutions. Total loan and lease balances at FDIC-insured institutions declined by $128.8 billion (1.7 percent) during the fourth quarter. This is the sixth consecutive quarter that aggregate loan balances have fallen. In 2009, loan balances declined by $587.3 billion, or 7.5 percent, which was the largest percentage decline since 1942.

As shown in Table 1, much of the decline in loan balances occurred at larger institutions. Institutions with total assets greater than $100 billion as of December 31 reported an aggregate net decline in total loans and leases of $116.8 billion in the quarter, or over 90 percent of the total industry decline. On a merger-adjusted basis, at community banks that filed reports as of December 31, total loan and lease balances decreased $4.3 billion during the quarter. A majority of institutions (53.2 percent) reported declines in their total loan balances during the quarter.

Table 1. Loan Growth by Asset Size Groups, Fourth Quarter 2009
(Dollar amounts in billions)

Asset Size	Number of Institutions	Number Not Reporting Increase in Loans	Number Reporting Increase in Loans	Aggregate Net Change in Loans ($ Billions)	Percent Change
> $100 Billion*	48	40	8	(116.8)	-2.82%
$10 - $100 Bill.	77	55	22	9.6	0.74%
$1 - $10 Billion	554	372	182	(16.9)	-1.78%
< $1 Billion	7,333	3,794	3,539	(4.3)	-0.41%
All Insured Institutions	8,012	4,261	3,751	(128.4)	-1.73%

Note: Reflects changes in loan balances for institutions categorized by size group as of December 31, 2009. Changes in these groups are adjusted for mergers and acquisitions. The difference between the net decline on this table ($128.4 billion) and the industry aggregate net decline ($128.8 billion) reflects institutions that closed during the quarter but were not acquired by another institution.
Source: Call and Thrift Financial Reports.
*The > $100 billion asset size category includes insured depository institution affiliates that would otherwise fall in smaller size groups.

Credit Quality and Lending Activity in Arizona

Arizona has been particularly hard-hit by the recent economic downturn. More than 10 percent of the state's jobs have been lost since mid-2007. Average home prices are nearly 40 percent below peak levels and commercial real estate markets have been strained by higher vacancy rates. Nevertheless, Arizona remains poised for recovery as a result of continued population growth and strong high tech and service-sector capacity.

The financial condition of insured depository institutions headquartered in Arizona remains weak, reflecting the severe economic downturn that the state has endured. In 2009, the median pre-tax return on assets for insured depository institutions in Arizona was the second lowest in the nation at negative 2.33 percent. Loan loss provisions reached record levels in 2009 and weighed heavily on earnings. Loan delinquencies for Arizona institutions in fourth quarter 2009 were also among the highest in the nation and the state's institutions reported record-high net charge-off activity during the year. After posting double-digit loan growth rates since the early 1990s, Arizona depository institutions reported a median loan growth rate that was marginally

negative in fourth quarter 2009, led by sharp slowdowns in construction and development, commercial and industrial, and consumer lending.

Factors Affecting Small Business Lending

Weak economic conditions have created an extremely challenging business environment throughout the nation, which particularly affects small businesses. After real GDP posted four consecutive quarters of decline during the second half of 2008 and first half of 2009, economic activity is now showing some signs of recovery. Consumer spending rose in both the third and fourth quarters of 2009 after declining in three of the prior four quarters. Even the housing sector showed some signs of stabilization in sales and prices during the second half of 2009. However, the unemployment rate remains high -- 9.7 percent as of March 2010 -- and persistent labor market weakness poses ongoing risks to the business outlook. Small business optimism remained near record low levels in March, according to a survey by the National Federation of Independent Business (NFIB).[2]

This weakness in business conditions has had significant effects on both credit demand and supply. The demand for business credit tends to vary over the business cycle with the level of spending on new capital equipment and inventories. Small businesses reported that capital spending levels remained near record low levels in March 2010, as did the demand for credit to finance such projects.[3] Similarly, in the Federal Reserve's

[2] "NFIB Small Business Economic Trends," April 2010.
[3] "NFIB Small Business Economic Trends," April 2010.

most recent *Senior Loan Officer Opinion Survey*, banks again noted weaker loan demand from business borrowers, especially from small businesses. At the same time, access to credit remains difficult, as lenders raise credit standards in response to higher loan losses. Banks continued to report net tightening of their lending standards on business loans in January 2010, although the pace of that tightening has slowed.[4]

Surveys of small businesses suggest that while small business loans have clearly become harder to obtain, deteriorating business conditions appear to represent an even larger problem. In the NFIB's March 2010 survey, the percent of respondents who said that loans were "harder" to get in the last three months outnumbered those who said loans were "easier" to get by 15 percentage points. In addition, the percent of respondents citing "finance and interest rates" as their single most important business problem stood at 5 percent, compared to 4 percent a year ago. By comparison, a 34 percent plurality of respondents cited "poor sales" as their biggest business problem, up from 31 percent a year ago and 16 percent two years ago. The percentage of respondents who said that sales were "lower" in the last three months outnumbered those who said sales were "higher" by 25 percentage points.[5]

Ensuring that creditworthy small business borrowers have access to credit remains critical to sustaining the economic recovery. FDIC-insured institutions are a major

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[4] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, January 2010, http://www.federalreserve.gov/boarddocs/SnLoanSurvey/

[5] "NFIB Small Business Economic Trends." April 2010.

source of financing for small businesses, supplying over 60 percent of the credit used by small businesses to run and grow their businesses. Community banks have a particularly important role in lending to small businesses. As of June 30, 2009 (the most recent data available), community banks accounted for 38 percent of small business and farm loans, even though these institutions represented only 11 percent of industry assets.

Recent initiatives and proposals to support small business financing will help to sustain local communities and community banks. For example, the American Recovery and Reinvestment Act (ARRA), signed into law in February 2009, temporarily raised the guarantee levels on Small Business Administration (SBA) 7(a) loans and eliminated upfront borrowing fees on SBA loans in the 7(a) and 504 programs. ARRA also provided a range of tax cuts and tax incentives for small businesses, helping them to cope with the unusually harsh economic environment. In addition, the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF) was authorized to provide financing for SBA-backed loans. After these measures were implemented in early 2009, both the volume of SBA loan originations and the volume traded in the secondary market have risen above pre-crisis levels.[6] Further efforts to support small business financing will also provide important benefits to the overall economy.

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[6] U.S. Department of Treasury, "Treasury, SBA Host Small Business Financing Forum," November 18, 2009, http://www.treas.gov/press/releases/tg411.htm

The Role of Bank Supervision

As federal supervisor for nearly 5,000 community banks in the U.S., the FDIC and its examiners uniquely understand that bank lending is the lifeblood of our local and national economies. We share the widespread belief in making credit available on Main Street and working with borrowers that are experiencing difficulties.

The FDIC's bank examiners work out of duty stations located in 85 communities across the country, and are both knowledgeable of local conditions and very experienced in their profession. Many have seen more than one previous economic down cycle and recognize the critical role that banks play in credit availability. We believe that our examiners do their jobs with a keen understanding of the economic environment and real estate conditions where banks operate.

Concerns have been expressed by small businesses, trade groups, and members of Congress that the bank supervisors may be contributing to the lack of credit availability, and that examiners are discouraging banks from extending small business and commercial real estate mortgage loans. There are assertions that examiners are instructing banks to curtail loan originations and renewals, and are criticizing sound performing loans where collateral values have declined. We also have heard criticisms that regulators are requiring widespread re-appraisals on performing commercial real estate mortgage loans, which then precipitate write-downs or a curtailment of credit commitments based on a downward revision to collateral values.

FDIC examiners are not directly involved in bank credit decisions. Accordingly, the FDIC provides banks with considerable flexibility in dealing with customer relationships and managing loan portfolios. We do not instruct banks to curtail prudently managed lending activities, restrict lines of credit to strong borrowers, or deny a refinance request solely because of weakened collateral value. In addition, we encourage banks to be knowledgeable of local market conditions and closely review collateral valuations when a borrower's financial condition has materially deteriorated and a sale of the collateral may be necessary. We would not require a re-appraisal for a healthy performing loan. We leave the business of lending to those who know it best -- the community bankers who provide credit to small businesses and consumers on Main Street. The FDIC believes that bank supervision should avoid interfering with banks' day-to-day credit operations.

To reiterate the importance of bank lending at this critical stage in the economic cycle, the FDIC has an on-going dialogue between the Washington Headquarters, Regional Directors and our field examiners about credit availability. We have re-emphasized that examiners should encourage banks to originate and renew prudently underwritten commercial loans and work cooperatively with borrowers facing financial difficulties. Examiners will not criticize financial institutions for making good loans or entering into prudently structured workout arrangements. These expectations are consistent with the FDIC's bank examination process and policy guidance that has been issued to the institutions we supervise.

The crux of many of the complaints about refinancing commercial loans seems to center on what is a performing loan. We hear that loans are considered to be in performing status by many borrowers because they are current on the interest payments. However, in some cases, the interest payments are coming from the loan proceeds -- often because the borrower is in a deteriorating financial condition. It is difficult for the bank, and the examiner, to not consider this situation a potential problem. In other cases, borrowers complain that examiners are telling banks that more equity is needed when the collateral goes down in value. To be clear, FDIC examiners focus on borrower cash flow as the primary source of repayment during our credit reviews -- not on collateral support which serves a secondary or tertiary source of repayment. When reviewing loans during our examinations, we look at collateral documentation, but also closely focus on the borrower's financial strength, as well as other critical elements of credit support such as guarantor support, business cash flow and prospects. The borrower's willingness and ability to keep payments current, especially when economic conditions are stressed, is always the primary evaluative criterion for our loan reviews.

From a banking policy perspective, the FDIC has issued several statements that encourage financial institutions to continue making prudent CRE loans and working with borrowers that are experiencing difficulty. Most recently, on February 12, 2010, the regulators jointly issued the *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers* to encourage prudent lending and emphasize that examiners will apply a balanced approach in evaluating small business loans. We believe this statement will help banks become more comfortable extending soundly underwritten

and structured small business loans. The Interagency Statement is included an Appendix to this testimony.

Previously, the FDIC issued in March 2008 a Financial Institutions Letter on *Managing CRE Concentrations in a Challenging Environment* which reiterated supervisory guidelines for managing CRE portfolios, while encouraging banks to keep prudent CRE credit available in their markets. At the time, we recognized that credit for small business and commercial real estate had become relatively scarce, and our goal was to support banks' efforts to continue lending despite difficult market conditions.

In November 2008, the FDIC joined the other federal banking agencies in issuing the *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* to encourage banks to continue making loans available to creditworthy borrowers and work with mortgage borrowers that are having trouble making payments. The banking agencies remain committed to this Statement as it promotes lending to creditworthy customers, working with mortgage borrowers that need relief, and implementation of appropriately structured compensation programs.

Also, in October 2009, we joined the other financial regulators in issuing the *Policy Statement on Prudent Commercial Real Estate Workouts*. This Policy Statement encourages banks to restructure commercial real estate loans, applying appropriate and long-standing supervisory principles in a manner that recognizes pragmatic actions by lenders and borrowers are necessary to weather this difficult economic period.

Our efforts to communicate supervisory expectations to the industry should help banks become more comfortable extending and restructuring loans, and in turn strengthen business conditions and hasten a much-awaited recovery.

Conclusion

Large dislocations in real estate and credit markets are contributing to an economic recovery that is characterized by weak private demand and persistent high unemployment. While it will clearly take time to fully resolve these credit market dislocations, there is a clear need for policies that promote the prompt and orderly workout of existing problem loans and that enhance the ability of lenders to make new credit available to qualified household and business borrowers.

In concert with other agencies and departments of the federal government, the FDIC continues to employ a range of strategies designed to ensure that credit continues to flow on sound terms to creditworthy borrowers. Banks are being encouraged to work with borrowers that are experiencing difficulties during this difficult period whenever possible. While many challenges remain before us, the FDIC is confident that the banking industry as a whole is moving in the right direction -- toward sounder lending practices, stronger balance sheets, and a greater capacity to meet the credit needs of their communities.

APPENDIX

INTERAGENCY STATEMENT ON MEETING THE CREDIT NEEDS OF CREDITWORTHY SMALL BUSINESS BORROWERS
February 12, 2010

The federal financial institutions regulatory agencies[1] and the state supervisors[2] (collectively, the "regulators") are issuing this *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers* (the "Statement") to restate and elaborate their supervisory views on prudent lending to creditworthy small business borrowers.[3] This Statement builds upon principles in existing guidance, including the November 2008 *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* and the October 2009 *Policy Statement on Prudent Commercial Real Estate Loan Workouts*. The regulators note that while the October 2009 statement focused on commercial real estate, many principles articulated in that guidance are applicable to small business lending.

Some small businesses are experiencing difficulty in obtaining or renewing credit to support their operations.[4] Between June 30, 2008, and June 30, 2009, loans outstanding to small businesses and farms, as defined in the Consolidated Report of Condition (Call Report), declined 1.8 percent, by almost $14 billion.[5] Although this category of lending increased slightly at institutions with total assets of less than $1 billion, it declined over 4 percent at institutions with total assets greater than $100 billion during this timeframe. This decline is attributable to a number of factors, including weakness in the broader economy, decreasing loan demand, and higher levels of credit risk and delinquency. These factors have prompted institutions to review their lending practices, tighten their underwriting standards, and review their capacity to meet current and future credit demands. In addition, some financial institutions may have reduced lending due to a need to strengthen their own capital positions and balance sheets.

Supervisory Expectations

While the regulators believe that many of these responses by financial institutions are prudent in light of current economic conditions and the position of specific financial institutions, experience suggests that financial institutions may at times react to a significant economic downturn by becoming overly cautious with respect to small business lending. Regulators are mindful of the harmful economic effects of an excessive tightening of credit availability in a downturn and are working through outreach and communication with the industry and supervisory staff to ensure that supervisory policies and actions do not inadvertently curtail the availability of credit to sound small business borrowers. Financial institutions that engage in prudent small business lending after performing a comprehensive review of a borrower's financial condition will not be subject to criticism for loans made on that basis.

Underwriting and Risk Management Considerations

An institution should understand the long-term viability of the borrower's business, and focus on the strength of a borrower's business plan, including its plan for the use and repayment of borrowed funds. The institution should have an understanding of the competition and local market conditions affecting the borrower's business and should not base lending decisions solely on national market trends when local conditions may be more favorable. Further, while the regulators expect institutions to effectively monitor and manage credit concentrations, institutions should not automatically refuse credit to sound borrowers because of a borrower's particular industry or geographic location. To the maximum extent possible, loan decisions should be made based on the creditworthiness of the individual borrower, consistent with prudent management of credit concentrations.

For most small business loans, the primary source of repayment is often the cash flow of the business, either through the conversion of current assets or ongoing business operations. An institution's cash flow analysis should cover current and expected cash flows, and reflect expectations for the borrower's performance over a reasonable range of future conditions, rather than overly optimistic or pessimistic cases. Many small business borrowers also rely on their personal wealth and resources to support loan requests. A borrower's credit history and financial strength, including credit score, are components of assessing willingness and ability to repay, and should be considered in conjunction with other judgmental factors, such as the strength of management. The loan structure should be appropriate for meeting the funding needs of the borrower given the type of credit and expected timing of the business' cash flow. Further, an institution should analyze the secondary sources of repayment, such as the strength of any guarantor or collateral support, and the ability of the borrower to provide additional capital. Institutions should not place excessive reliance on cyclical factors, such as appreciating or depreciating collateral values.

An institution should have robust risk management practices to identify, measure, monitor, and control credit risk in its lending activities. Further, institutions should promote a credit culture in which lenders develop and maintain prudent lending relationships and knowledge of borrowers. This culture should encourage lending staff to use sound judgment during the underwriting process. While institutions may use models to identify and manage concentration risk, portfolio management models that rely primarily on general inputs, such as geographic location and industry, should not be used as a substitute for the evaluation of an individual customer's repayment capacity.

Examination Reviews

Examiners will not discourage prudent small business lending by financial institutions, nor will they criticize institutions for working in a prudent and constructive manner with small business borrowers. Examiners will expect institutions to employ sound underwriting and risk management practices, maintain adequate loan loss reserves and capital, and take appropriate charge-offs when warranted. As with all lending, examiners are expected to take a balanced approach in assessing the adequacy of an institution's risk management practices in its small business lending activities. As a general principle, examiners will not adversely classify loans solely due to a decline in the collateral value below the loan balance, provided the borrower has the willingness and ability to repay the loan according to reasonable terms. In addition,

examiners will not classify loans due solely to the borrower's association with a particular industry or geographic location that is experiencing financial difficulties.

[1] The federal financial institutions regulatory agencies consist of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the National Credit Union Administration (collectively, the "agencies").

[2] The state supervisors are represented through the Conference of State Bank Supervisors.

[3] Financial institutions should apply the principles of this Statement in accordance with their internal definitions of small business loans or as appropriate in their loan portfolios. Small business lending includes loans to small businesses and farms, such as working capital lines of credit, secured and unsecured term loans, as well as unsecured revolving credit.

[4] Responses to the Federal Reserve Board's Senior Loan Officer Opinion Survey indicate that the net fraction of banks that tightened credit standards and terms on C&I loans to small firms was very high in 2009, and exceeded its previous highs in the past twenty years.

[5] The data is for commercial banks, where small business loans, as reported in the Call Report FFIEC 031 and 041, schedule RC-C, part II are defined as loans with original amounts of $1 million or less that are secured by nonfarm nonresidential properties or commercial and industrial loans plus loans with original balances of $500,000 or less for agricultural production or secured by farmland.

Chair WARREN. Okay. Thank you, Mr. Ivie. So we're going to do some questions. We'll try to hold ourselves to five minutes, at least in this first round, and I'll start first with Mr. Blaney, if I could.

SBA loans are what portion of total small business lending? What portion of small business lending comes through SBA?

Mr. BLANEY. I don't know the answer to that question.

Chair WARREN. It's a very small fraction, isn't it?

Mr. BLANEY. It's a smaller fraction, but I do not know the answer to that question.

Chair WARREN. Okay. Sir, well, let me ask it a different way then. Knowing it's a small fraction, when the Government says it's going to put programs in to do more SBA lending, do we have any sense of how much leverage that's going to create; that is, how much change it's going to make in the availability of credit for small businesses?

Mr. BLANEY. Well, we have seen an increase in lending——

Chair WARREN. Can you hold the mic just a little bit closer to you?

Mr. BLANEY. We have seen a general increase in lending this year as a result of the Recovery Act. Last year we only did 960 loans in this state and this year year-to-date we've done 684. So we've seen that there's been a general increase.

Chair WARREN. Do you have any idea—that's 684 out of how many loans?

Mr. BLANEY. I don't know. I don't know what commercial——

Chair WARREN. What I'm trying to figure out is not whether you did 680 loans but whether that's a drop in the bucket or that half fills the bucket because we're really trying to figure out the role the SBA plays here.

Mr. BLANEY. Yes. Unfortunately, I don't know what commercial lenders are doing. I only know what they're doing with SBA.

Chair WARREN. Okay. Let me ask a different question then of the SBA. Would the SBA be more effective if it became a direct lender again instead of working only through financial institutions?

Mr. BLANEY. Well, we've been asked that question and many people are asked why SBA doesn't make loans directly, and direct lending would require hiring a new workforce and significantly expanding our reach. It would require us to set up or stand up a massive bureaucracy and SBA would not be able to make its first direct loan for approximately a year or more.

Chair WARREN. Okay. Well, I get the timing part. Are you telling me that the banks now have a massive bureaucracy to do this?

Mr. BLANEY. Well, no, ma'am.

Chair WARREN. Then why would it take you a massive bureaucracy to do?

Mr. BLANEY. Well, we have to have more people to do it.

Chair WARREN. Well, why would it be a massive bureaucracy when you do it but the banks are doing it now without a massive bureaucracy?

Mr. BLANEY. I'm afraid that would be a policy question and I'm a civil servant, ma'am. I run this office here.

Chair WARREN. But you just gave me that answer.

Mr. BLANEY. Yeah. And we'd have to have a whole operations section to do it and that would be several hundred people for credit purposes.

Chair WARREN. So for you to do what the banks do would require a massive bureaucracy but it doesn't require the banks——

Mr. BLANEY. Well, massive bureaucracy is a bad term. It would take a lot of people to run a center for lending.

Chair WARREN. Okay. Maybe I should ask some questions of the FDIC while we've got you here.

So are banks contracting credit, Mr. Ivie? What are you seeing from your perspective?

Mr. IVIE. I think banks, and community banks in particular, want to lend to borrowers. The trouble is finding creditworthy borrowers. The demand is——

Chair WARREN. Well, which is——

Mr. IVIE [continuing]. Not there.

Chair WARREN. That's what I'm really trying to ask—supply and demand. Are you seeing a demand contraction or are you seeing a supply contraction? I realize you may be seeing some of both, but do you have some sense of which one seems to be driving things here?

Mr. IVIE. Yes. Some of both. I think our community banks clearly want to lend, but the demand is not there from the creditworthy borrowers. It appears that healthy borrowers who could borrow are not interested in borrowing at this time. I think it's a confidence issue and once we see the economy start to recover and employment start to recover, then I think the businesses will be more willing to borrow.

Chair WARREN. Okay. So you've just given me two demand side answers; that is, those who are asking for credit don't deserve it and those who deserve it aren't asking for it. So that's why you think lending has contracted, small business lending?

Mr. IVIE. And also banks—it's true that many banks have financial difficulties right now with their credit quality and they need to reserve their capital for losses and future losses, which result in less capital and liquidity to lend to borrowers.

Chair WARREN. So another problem that we're seeing is because the banks themselves are in financial trouble, presumably because of their real estate loans or their commercial real estate loans, and don't want to lend. They want to hang on to their capital.

Do you have any sense of what they're doing with their excess capital right now?

Mr. IVIE. Yes. Again, I think banks want to lend, if they have the available capital to be able to lend. If they don't find acceptable loan demand, Fed funds are an option for some of the banks at this time.

Chair WARREN. I'm sorry. I'm not quite understanding. So are you saying the banks don't have any excess capital right now?

Mr. IVIE. Some banks do, some banks don't. Banks that are in trouble do not have excess capital at this time.

Chair WARREN. Okay. I got that part. And the banks that do have excess capital, what are they doing with it?

Mr. IVIE. I think they are striving to lend to borrowers. When they do not have sufficient borrower demand or creditworthy borrowers——

Chair WARREN. You think they're out there trying?

Mr. IVIE. I do think they're out there trying.

Chair WARREN. Okay. My time is up. Mr. McWatters, the mic is yours.

Mr. MCWATTERS. Thank you. I was looking over the written testimony of James Lundy. He's the CEO of Alliance Bank of Arizona, and on page three of his testimony he says that "increased capital requirements for the banking industry may make sense, particularly for banks with higher risk profiles. However, increased capital requirements should be phased in, perhaps over a two-to-four-year period, allowing the industry to deal with capital issues more strategically." So phasing-in capital requirements.

On the next page, Mr. Lundy says, "Regulators are stretched very thin but they seem to have too little flexibility in their examination procedures and process which exacerbates the resource shortage." So too little flexibility.

Third, Mr. Lundy says, "Recently, compliance exams have an increasingly hard edge to them, to which the community banker becomes frustrated," and the like.

So this is from a real live banker, not from a Member or panelist. Do you have any comments with respect to phasing in capital requirements, too little flexibility regarding examination procedures, and this so-called hard edge?

Mr. IVIE. Well, I agree that many of our banks are having difficulty and they need to deal with their own problems. Prompt corrective capital ratios of five, six, and ten percent, those are for a well-managed bank in a stable environment. Capital needs to be commensurate with the risk in the bank's portfolio and that is requiring higher levels of capital when there are risky loans on the books.

In terms of flexibility, we strive to be very balanced and flexible in dealing with our banks. We issue guidance on how we would evaluate loans to try to clarify our processes to the industry, which we hope will make them more comfortable in making loans.

As far as compliance exams, we take consumer protection very seriously at the FDIC. We view the FDIC seal as a Good Housekeeping Seal of Approval and if a bank is going to have the FDIC seal on its front door, we want customers to know that they're going to be treated fairly by that institution.

So we do enforce our consumer protection laws equally with our safety and soundness.

Mr. MCWATTERS. Okay. Thank you. Mr. Blaney, any comments to that?

Mr. BLANEY. No, sir.

Mr. MCWATTERS. Okay. Lynne Herndon, President of Compass Bank, Phoenix, she writes in her opening statement that "many banks in Phoenix are beyond the current capital guidelines for commercial real estate and so much so that their ability to make business loans is impacted." Okay. So too much CRE depresses regular non-CRE loans.

"Many banks are shrinking their overall balance sheets in order to come closer to the guidance." Okay.

"Unfortunately, in many cases this means asking creditworthy borrowers to leave as these are the loans most easily placed with another bank." That seems like the last thing you would want to do is ask a good customer to leave.

She concludes by saying, "All these requirements serve to dampen lending in a time when we need to be expanding."

Any observations on her concerns?

Mr. IVIE. Commercial real estate concentrations are a significant problem, especially in the West. Many banks are looking to shrink their balance sheets to preserve their capital. Their capital is being eroded from charged-off loans and provisions for future loan losses. The FDIC does not instruct a bank to get rid of its creditworthy borrowers.

I think it's more that if they don't have the capital, they're trying to improve their capital ratios by shrinking their balance sheet and that may be why they are not lending or running off some of their CRE loans.

Mr. MCWATTERS. Okay. Thank you. I'll stop there.

Chair WARREN. Good. Thank you. Mr. Silvers.

Mr. SILVERS. Thank you. Mr. Ivie, in your written testimony, which is very helpful, very detailed, there is a chart on page four of loan growth in the last quarter of last year. It shows that, all in all, insured institutions' loan growth shrank by $128 billion. $116 billion of that shrinkage came from institutions over a $100 billion, and we actually saw growth in lending among, I guess we might call them, medium-sized financial institutions.

Can you speak to this in the context of what I think most people believe was a rapidly-improving economy, whether sustainable or not is another question, but an improving economy at the last quarter of 2009 as shown by the basic GDP numbers and the like? Can you explain what is going on here and particularly talk to not the question of whether or not there was a deterioration in general business conditions during 2008 and 2009, which clearly there was, and clearly there was a decrease in demand as a result for lending, but the question of, in light of this data, how serious a problem we have as the economy begins to improve a little bit and whether the supply of credit is going to act as a brake on that improvement?

Mr. IVIE. Yes, that's definitely a concern. I think what the chart reflects is that you have community banks who are locally based and that may be why they can continue to make loans. They're locally based. They work and live in the communities and they're better positioned to lend locally. So I think that's why you'll see the community banks lending and perhaps why the larger banks that are the money center banks not lending.

Mr. SILVERS. So your view would be—do I read you right to say that community banks essentially are taking a more qualitative approach? They have a more kind of three-dimensional knowledge of their borrowers and the large banks maybe are doing more quantitative model-driven lending? Am I reading you right?

Mr. IVIE. I would say that's accurate. Community banks do much more relationship lending in their communities.

Mr. SILVERS. Now, one of the witnesses, one of the bank witnesses, and I apologize, I don't recall which, points out that, at least in this area, 70 percent of the commercial bank market is four large national institutions.

In light of what you're saying and pointing out, is that type of concentration an obstacle here to adequate credit provision on the upside, given what we just exchanged?

Mr. IVIE. Again, I think community bankers are best positioned to lend to small businesses because of their relationship and their knowledge of the local communities. So that would seem to make sense.

Mr. SILVERS. If that's so, how serious a problem is the looming commercial real estate problems in community banks which our panel has reported on and which you allude to, I believe, in your testimony?

Mr. IVIE. Right. It's a serious problem for our community banks. They have large concentrations. Commercial real estate was a niche that community banks fulfilled because they had that local relationship and local knowledge of the markets.

We are seeing some improvement and stabilization in terms of prices. Many bankers report to me that they are able to sell their properties for what they had written them down to at this point, so that's a good sign, but it will take some time to work through that concentration.

Mr. SILVERS. So you don't see continued pressure on the commercial real estate asset side on community banks? You think it's bottomed out?

Mr. IVIE. I don't know if it's bottomed out. The decline, rate of decline has slowed.

Mr. SILVERS. The rate of decline is slowing.

Mr. IVIE. Right. The rate of decline is slowing. We are seeing some stabilization in terms of prices. The banks have written it down to an amount that they can now sell and recover their funds. It's still a serious problem going forward.

Mr. SILVERS. Mr. Blaney—thank you, Mr. Ivie. Mr. Blaney, I understand from your response to our Chair's questions that you're really focused on the work of the SBA.

I'm curious, though, in the course of your dealing with the borrowers that come to you and work through you, what perceptions or what sense have you gotten from that and interactions with the world of non-SBA lending because—let me just be specific.

One could interpret what you say is the serious growth in SBA lending as, in part, reflecting the inability of your clients to get conventional loans because they're not available or have become less available.

Mr. BLANEY. Again, I think it also depends on the bank. There are some banks that we deal with who only do SBA lending. They don't do any form of conventional lending. They do SBA lending. They sell their loans in the secondary market and that funds other additional loans.

People come to us usually when they're having difficulties with their loan and we have worked throughout this state to—we've run a number of programs for people to teach them to ask for deferments and that sort of thing so that they have some idea of

what to say when they go back to the bank when they're having difficulty.

As far as folks coming to us, we have people every day that are looking for money. We run workshops where we talk about that for people so that they can go to a bank and apply for an SBA loan and again, you know, it depends on the bank. Some banks do both conventional and SBA. Some banks here in Arizona just do SBA lending, period.

Mr. SILVERS. Thank you. My time has expired.

Chair WARREN. Thank you. Superintendent Neiman.

Mr. NEIMAN. I first want to thank Mr. Ivie especially, for traveling from San Francisco to participate in this hearing.

The public should also know, as well as the panel members, that we did try to get some of the large lenders, including a large San Francisco lender, Wells Fargo, to participate here with us to get the perspective of one of the largest lenders. They declined to participate, in fact even in providing an executive from the Arizona operations, and we were greatly disappointed.

What we have been hearing from the borrowers and small businesses is a common thread—a common theme—that banks are tightening and, in many cases, in my opinion, correctly tightening underwriting standards are not distinguishing between sound creditworthy borrowers and weak risky borrowers, and, in fact, one of the bankers identified as painting with a broad brush. Hence, if that is true, banks are missing good lending opportunities.

You know, based on your experiences within the institutions, is this true?

Mr. IVIE. Again, I think banks are in the business of making loans. They want to make loans. We recently issued our Interagency Statement on Meeting the Credit Needs of Small Business Borrowers. We put that out particularly to try to ensure that our supervisory policies are not indirectly curtailing lending at our financial institutions and to let our banks know we expect them to monitor concentrations, but they should not automatically refuse credit and they will not be subject to criticism if they do a comprehensive analysis and restructure their loans.

Mr. NEIMAN. And one way to get banks to identify good business opportunities is to work with borrowers, whether in an educational program or in restructuring the loans or telling them what do they have to do in order to become a creditworthy borrower.

Are you seeing those levels of interaction between banks? I'm also interested: Is there a distinction between the small banks, the regional banks, and the large banks in their commitment to working with borrowers to assure that they are—so that you're not losing the opportunities for those creditworthy borrowers?

Mr. IVIE. Right. We've issued numerous statements and guidance to the industry encouraging our banks to work with their borrowers to restructure their loans. That's critically important in this economic period.

In fact, we've actually just reached a partnership with the Small Business Administration where we are going to provide financial education to small businesses to help them understand the financial system.

What I can speak to is that I know community banks, the smaller banks, do want to lend and they are working with their customers.

Mr. NEIMAN. So, you're seeing a greater reluctance from the larger banks in working with customers, or, if you can put it another way, you're seeing a greater effort on the part of community banks?

Mr. IVIE. Yes. I'm seeing a strong effort on the part of community banks.

Mr. NEIMAN. Okay. Do you see a need—you heard me in my opening statement talk about our New York Business Development Corporation that facilitated through a consortium of both equity and financing from member banks expanded opportunities to lend to small businesses where the investing banks would maybe not have taken on those loans and very likely would have declined those loans, but because of the singular focus of this Business Development Corporation to have the underwriting standards, to be able to work with borrowers, it's proven to be a successful model.

Is that something that you have seen in other regions or would endorse as an approach worth exploring?

Mr. IVIE. I have not seen that approach in other regions. It sounds like it's definitely an approach worth exploring. I think the more avenues that are available to creditworthy borrowers the better we will all be.

Mr. NEIMAN. Great. Mr. Blaney, you know, one of the challenges and in fact frustrations is in the collection of data and you got that very clear from Chair Warren's first question.

Are there any recommendations that you have that could help the country get a better sense of the data around small business lending, particularly the effectiveness of SBA programs?

Mr. BLANEY. Sir, that's really a policy question, and, at my level, I'm the district director here in Arizona. I do not make policy. I implement policy from Washington and so, respectfully, I don't have an answer for you on that.

Mr. NEIMAN. Thank you. Are there any policy, regulatory—I'll ask Mr. Ivie—any regulatory or policy responses that we could be addressing, either by regulators or others, to address this, the issue of having banks, both large and small, ensure that they're not missing business opportunities?

Mr. IVIE. I think we've structurally put that in place with our various announcements and statements to the industry on what our approach is going to be, trying to make them comfortable and less cautious, so they will make prudent loans to creditworthy borrowers.

Mr. NEIMAN. And are they understood from your perspective?

Mr. IVIE. That's an ongoing process. I frequently hold banker roundtables to discuss that with them. We hold conference calls with the industry and internally, as well, to explain to our own staff what our approach is going forward. So it's a continuing communication effort that we will continue to do.

Mr. NEIMAN. Thank you. My time has expired.

Chair WARREN. Thank you. I just want to follow up on this question about data.

We asked, I asked earlier about your impression about the supply and demand difference. Some banks are looking, you say, for

loans, others are not. Are there any hard data that help us sort any of this out? You know, the banks say, "gee, I just don't see any good customers". The people who are looking for loans are saying, "I just don't see any banks that want to lend", and unless there's some giant disconnect occurring in America, one side must have a better handle on the truth than the other here.

Are there any data to support one claim over the other?

Mr. IVIE. We do track loan volumes and loan volumes are declining.

Chair WARREN. Okay. So we know for a fact credit is shrinking.

Mr. IVIE. That's correct.

Chair WARREN. Okay.

Mr. IVIE. That's right. Underwriting standards are being tightened. Banks are shrinking to try to preserve their capital ratios. So there is a lower volume of lending at this time.

Chair WARREN. Right. So it sounds like banks are making less money available.

Mr. IVIE. Well, I think they have less money to make available because they have their own credit quality problems. They have to—they've charged off loans. They have reserves for future loan losses. That's reduced the amount of money they have to lend to borrowers. That's for troubled banks.

Chair WARREN. Okay. So you'd recommend we take a look at charge-offs as a way to understand this?

Mr. IVIE. I think the way to understand it is to look at the——

Chair WARREN. I just mean in shrinking the money available? This is the supply side. I'm still trying to focus on the question.

Mr. IVIE. That's right.

Chair WARREN. Okay. Let me ask you another one along this same line. We hear the complaint from banks, and sometimes from their customers because it's been related by banks, that supervisory standards have gotten too tough and I think Mr. McWatters alluded to this in one piece of the testimony.

I would expect people to complain that their regulators are too tough. The question is again do we have any data on this? Is there any way to assess this independently?

Mr. IVIE. I don't know if you're going to get actual data on that. The problem is banks that have credit quality problems, they need to cleanse their balance sheets and have an accurate recording of their assets on their balance sheet. That's the first step to recovery. Once the problem is defined and investors can identify the extent of the problem, then new money can come into these institutions to lend to borrowers.

Chair WARREN. Okay, one last question. There's a new program coming out, the Small Business Lending Fund, and the argument is that banks will participate in this who didn't want to take TARP money because of the stigma associated with TARP money.

Do you believe banks will want to participate in this? It's going to be a different kind of program. Do you anticipate something different here?

Mr. IVIE. Yes. I hope banks will want to participate. I know they do want to lend. There obviously is a perception issue with TARP and kind of a bailout backlash.

Chair WARREN. And do you think this fixes that problem?

Mr. IVIE. It's a step in the right direction.

Chair WARREN. And how is it a step in the right direction?

Mr. IVIE. Well, it's a tool.

Chair WARREN. By giving it a name?

Mr. IVIE. It's a tool that should help. It's funds that will be available for banks to access to lend to their customers.

Chair WARREN. But this is presumably for banks that wouldn't take the funds through another program.

Mr. IVIE. Well, I think you will see banks that will apply for the funds.

Chair WARREN. That will want the funds?

Mr. IVIE. Yes.

Chair WARREN. Okay. Alright. That's it for me. Mr. Silvers, do you have any questions? Mr. McWatters? We're good? Mr. Silvers.

Mr. SILVERS. Like Elizabeth, I have one or two questions.

Mr. Ivie, I think that the data in your testimony would suggest that the Capital Purchase Program under TARP may have been less than fully successful in reviving business lending, particularly at the small end.

But what lessons can we take away from this experience for the program Treasury's proposing that would require congressional action or some other steps? What can we learn?

Mr. IVIE. I think one difference is a year ago when TARP was being offered, we were still in a declining economic environment. Losses were continuing to accumulate. No one knew where that bottom was.

Today, things are starting to stabilize and I think banks will be more willing to access that money and actually lend that money because they're not trending downwards as fast as in the past when new capital was eaten up by continuing losses.

Mr. SILVERS. Okay. So you're suggesting that a dollar today might not be quite so swallowed up by losses as a dollar a year ago or a dollar a year and a half ago?

Mr. IVIE. I would agree with that. Banks have taken really heavy provisions and losses in 2009. Our data shows that the third quarter of '09 was probably the peak period for provisions and write-downs.

Mr. SILVERS. And this is—I'm not taking my questions out of order, but you said a moment ago that there are continuing issues, in response to a question from our Chair, you said a moment ago there are continuing issues with write-downs.

In your view, and I would ask you to answer this question with respect to community banks and with respect to very large institutions separately, are the balance sheets clean? Do we have institutions that have gotten themselves to the point where that transparency, that realism exists on those balance sheets, such that lending can move forward?

Mr. IVIE. Yes. We're a lot closer than we were a year ago. We monitor institutions closely, not just through examinations but through quarterly call reports. There's been large amounts of provisions that have been taken and I think the balance sheets are much more accurate than in the past.

As a result of that, we are starting to see capital come in to some of our institutions. We've had several of our institutions recently have success in accessing the capital markets and raising capital.

Mr. SILVERS. Finally, this hearing in large part is focused on small business lending. Obviously we have a representative from the SBA here, Mr. Blaney, but something that concerns me deeply is that we have essentially very small enterprises on the one hand and then we have public corporations that can access public credit markets and then there is a lot of business in between that does a lot of the work of our economy, employs a lot of our citizens, whose financing needs are larger than the SBA limits but who can't access the public credit markets efficiently.

For that type of business, the 200 to 400 employee kind of business, what kind of credit environment does the FDIC see there?

Mr. IVIE. It's a difficult credit environment everywhere. I think there are banks, regional banks and community banks, that can service those customers. They can do participations with other institutions to be able to increase their lending limit to be able to serve those types of customers.

Mr. SILVERS. We've taken a lot of your time and so my time has, I think, probably come to an end, but I would very much appreciate if the FDIC and its staff could work with our staff on data that describes the lending environment for that segment of our economy.

Mr. IVIE. Okay. I'm sure we will follow up on that.

Chair WARREN. Thank you. Thank you, Mr. Ivie. Superintendent Neiman.

Mr. NEIMAN. Just a few questions. I do encourage you to review the testimony of the banks as well as the borrowers and, to the extent that your time permits you, to stay and hear not only their testimony but our questions and answers. I think we would appreciate that, as well.

Two of the points that were raised were of particular interest to me as a state regulator. One of the bankers, in talking about the CRE guidance that is out there in the world dealing with and applying it to banks, was a recommendation that banks could benefit, and the public could benefit, if there was a differentiation in the vintage year for calculating CRE concentrations, that certainly there are distinctions between loans made in 2004 and CRE made in 2006.

So I don't know if you have given any thought to that or would like to comment on that particular recommendation.

Mr. IVIE. Yes. 2005 and 2006 were difficult vintage years. We encourage our examiners not to take a blanket approach, to take a case by case approach. There are good loans and bad loans made during all those periods and we encourage them to look at the specific credit and make that decision and not take a blanket approach. We have flexibility to assign capital ratios based on our assessment of that individual bank's portfolio.

Mr. NEIMAN. So similar concentrations at two different banks may not be treated the same, based on the quality and vintage of those commercial credits?

Mr. IVIE. That's correct. Concentration is one factor. How the loans were underwritten when they were initiated is probably the bigger factor.

Mr. NEIMAN. Another banker raised an issue around to the extent that loan loss reserves should be treated in capital ratios and should be given more weight.

Do you have a particular view? I know it's been reported that Chairwoman Bair has a different view on the increases in the ability to take into consideration loan loss reserves in capital ratios from the Comptroller.

Mr. IVIE. Well, my view would be the same as Chairwoman Bair's.

Mr. NEIMAN. Thank you.

Chair WARREN. Thank you. With that, we thank this panel very much. Thank you, Mr. Ivie. Thank you, Mr. Blaney. The witnesses are excused.

I'm going to call the other witnesses to the stand, please, and I'll introduce them as we do.

Candace Wiest, President and CEO of West Valley National Bank; Lynne Herndon, Phoenix City President for BBVA Compass Bank; James Lundy, President and CEO of Alliance Bank of Arizona; Mary Darling, CEO of Darling Environmental and Surveying; Cindy Anderson, CEO of Great Biz Plans; and Paul Smiley, President of Sonoran Technology and Professional Services.

We thank all of you for your willingness to share your perspectives today and we look forward to hearing from you. As before, I'm going to ask you to keep your initial remarks to five minutes, even less if you possibly can, so that we will have time for some questions afterwards. How about if we start down here with Ms. Anderson?

STATEMENT OF CINDY ANDERSON, CEO AND PRESIDENT, GREAT BIZ PLANS

Ms. ANDERSON. Certainly. Good morning, Ms. Warren and members of the Congressional Oversight Panel.

My name is Cindy Anderson. I own Anderson Business Development, Inc., also doing business as Great Biz Plans, based in Scottsdale, Arizona. We provide customized business planning and consulting services—can you guys hear me? Okay. Good.

Chair WARREN. Why don't you pull the microphone up just a little bit closer so everyone else can?

Ms. ANDERSON. Glad to do that. We provide customized business planning and consulting services to business owners looking to start and grow their business. Our clients are almost always in need of funding from lenders or investors and many are franchises and start-ups.

Like many entrepreneurs, I personally funded the start-up and expansion of my business. In 2005 to 2006, I tapped into a $150,000 of the equity in my home to launch the Great Biz Plans brand. We've served nearly 200 clients in the United States, Canada, Mexico, Germany, and my newest international client is in Kuwait.

My business has changed pretty dramatically since I started consulting in 1998 and I've been greatly affected by the financial crisis and credit contraction. September 2007 was our largest revenue month ever, yet based on the negative trends in my business, that same month was also when I laid off employees and radically cut

expenses, including my payroll. My business was at the start of what would become a steady two-year decline. My clients and prospects no longer were able to capitalize or collateralize loans to start and fund their businesses. My business was in the ICU. Running and growing a small business isn't for the faint of heart.

Also, the credit and financial crisis had an extreme impact on my clients. For the past 10 years, business owners have used their home equity and other personal assets to fund and secure their working capital needs. I particularly appreciated Superintendent Neiman's comments. Those personal loan funds and assets just aren't there anymore.

My clients have a hard time coming up with the capital or the collateral to make themselves attractive enough to lenders. Most of the business owners I'm referring to are genuinely solid. They look great on paper. Yet somehow they just don't fit that elusive lending criteria. They're almost never given an honest helpful explanation as to why their loan application was rejected again, just that it wasn't approved.

It's fair to generalize that banks just aren't lending anymore and when they are, it's with a select few that are in fortunate circumstances and fit the banks' changing and silent lending criteria. It's not that loan demand is down, the problem is that supply has dried up. Most small business owners are just not able to access capital. The rules of the game have changed, admittedly for the lenders and for the borrowers. The problem is that most often these rules, ratios, and criteria and even the terminology are not made plain to the prospective borrowers.

The lending market needs innovative ways to support business owners and start-ups to fuel economic growth. Lending needs to be there for them with plainspoken criteria and enough funds to support smaller, non-real estate-linked small business loans in a way that works for both the lenders and the borrowers.

I have three concerns about the current situation I'd like to share with you now.

First, the bottom line appears to us that lenders have more money now than they've ever had with record profits. Among many other policies, their lending criteria have changed, as they should have, yet they have been given or were forced to take funds to stabilize the financial situation. Instead of moving those funds and profits through to the marketplace in the form of new loans which would stimulate economic recovery, they've held on to those funds and the resulting profits without releasing them back into the very markets they were chartered and funded to serve.

Second, well-intentioned bankers are still networking in the community, meeting with prospects, marketing their banks' services, though few are personally making claims that lending is up. They're out there looking for that top 10 in their local market for owners and niche industries. Most businesses don't fit lenders' new and often closely-held criteria. These mixed messages are very confusing to borrowers.

Third, lenders are still largely not loaning money to the small businesses, to the start-ups, to those that create the majority of jobs in this state. Lending may be up from its dead standstill but it's still stalled.

In closing, there is good news. My business is up remarkably from last year. March of 2009, my revenue was $438 in my business. March of 2010 was my company's second highest revenue month ever. Demand is definitely bouncing back in response to improving economic conditions and entrepreneurs are on the move bootstrapping and self-funding their growth.

Thank you.

[The prepared statement of Ms. Anderson follows:]

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April 27, 2010

Ms. Elizabeth Warren, Panel Chair
Congress of the United States
Congressional Oversight Panel
732 North Capitol Street, NW, Room C-320
Washington, DC 20401

Dear Ms. Warren and Congressional Oversight Panel,

My name is Cindy Anderson, and I own a business consultancy called Anderson Business Development, Inc. dba Great Biz Plans. We provide customized business planning and consulting services to business owners across the country and internationally, as well as to clients in Arizona.

Business owners that most need our services are those looking to start or grow their businesses. Typically our clients are either brand new, or in their first three years of business, or making efforts to dramatically grow their business. They need help with business strategies for new business development, they need help understanding their business model and value proposition (that is, how they make, spend, and earn money), and most importantly they need help developing sophisticated financial projections that support their plans. Our clients are almost always in need of funding from lenders or investors.

Background – History and Services, Capital Needs, Sources of Funds

My business has changed pretty dramatically since I started consulting in 1998. Over the years, while working very closely with several lenders, I developed a proprietary process for writing business plans that is especially suitable for those seeking loans – mostly SBA 7A working capital loans of less than $1 million. I found and filled a niche in writing business plans for franchises and start-ups.

Like most small business owners, I personally funded my business. In 2006 I tapped into the equity in my home to launch the Great Biz Plans brand and spent $150,000 to develop business processes and marketing systems that were scalable, plus payroll and other working capital needs. I grew my company to a staff of eight employees and contractors. To date, we've served just fewer than 200 clients in the United States, Canada, Mexico, Germany, and my newest international client is in Kuwait.

Affects of Financial Crisis, Credit Contraction

★ Affects on Great Biz Plans

After I launched the Great Biz Plans brand, we were successful in garnering a steady flow of clients and work for the next several years. During the summer of 2007, coincident with the decline in the housing market, I noticed that we had almost no hot prospects and a declining number of new clients in the pipeline. September 2007 was our largest

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revenue month ever. But due to several negative trends, it was also the month that I laid off two employees, radically cut back hours for all staff, and converted my Sales Director to straight commission.

In mid-2007 my business experienced the start of what would become a steady decline. My clients and prospects no longer had funds to access or pledge toward working capital and collateral to get themselves loans to fund their businesses. In 2008-2009 I experienced dangerously low-revenue and even several no-revenue months. Frankly, I was unsuccessful at finding a job, so I was back to being a solo-preneur and have continued in that role today.

Like many of my clients and other small business owners, my own personal financial situation is greatly diminished because of the link between declining home and financial markets. I never would have expected that the 50+% equity I had in my home when I took out my HELOC would be gone, and never anticipated bring in a position to need to repay that loan out of my personal funds. I have been unsuccessful in restructuring the debt, caught in the home loan modification process with two lenders, lots of promises, and no results after 17 months and four trial programs that just go nowhere. This has harmed my personal credit-worthiness, and my business is not strong enough to take on corporate debt. Despite a sterling corporate payment history, due to the decline in my personal financial situation (coupled with the restructuring of the credit card industry), American Express has decreased the open to buy on our corporate credit cards.

★ Affects on Our Clients

Running and growing a small business in these economic times isn't for wimps!

As I mentioned, my clients are the very people that have been most affected by the housing crisis as well as the financial crisis. For the past 8-10 years, they have gone to their home equity and other easy-to-access assets to fund their portion of the working capital that's needed to start or grow their business, to secure lines of credit that fund payroll and inventory, etc. Those personal and loaned funds and assets just aren't there any more. Many that are still starting businesses or securing credit are doing so by rolling over their 401K's into a C-corporation to access their retirement funds for some or all of their working capital. Many others are just like me: they've scaled back to unsustainable levels, handling more with less, caught in a Catch 22 without adequate operating capital/bandwidth.

Some – a few – are able to secure SBA loans, mostly with community banks where they know the lender personally, have a viable business with at least two years of financials with the bank, have golden credit, are a Veteran, or operate in a select industry group that the lender's board or underwriting team has interest in, etc.

It's not that loan demand is down; the problem is that the supply has dried up. Most small business owners are just not able to access capital. The rules of the game have changed, admittedly for the lenders and for the borrowers. The problem is that most often, these rules aren't made plain to the prospective borrowers.

Well-intentioned lenders are still networking in the community, meeting with prospects, marketing their bank's services, looking for the "top ten" in their local market, solid real estate-backed loan candidates, or niche industries like medical and dental which are traditionally more attractive. The net worth of most of my clients is so greatly diminished that they have a hard time coming up with the capital or the collateral to make themselves attractive enough to SBA or other lenders. And most of these business owners I'm referring to are solid. They have viable businesses or they are experts in their fields or they have plenty of net worth and also really good credit. ***They look great on paper... yet somehow they just don't fit the elusive lending criteria. It's fair to generalize that banks just aren't lending anymore.***

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The Good News

My business has always been a pre-cursor to the economy. When 9-11 hit, we were hit first and hardest, and then we recovered more quickly than most. During this "Great Recession", we experienced pain earlier than most in 2007. The good news is that March 2010 was my company's second highest revenue month – ever. While the recovery I've experienced is not yet stable, the trend is very clear and very positive. Incremental gains are being made. The phone is ringing again – frankly, I'm swamped with business.

Business owners are making sales and growing their businesses again. Investors are buying franchises again. Franchisors are selling franchises again, too. Granted, entrepreneurs are self-funding their business development efforts. But they are starting to move forward. They are in meaningful motion to start and grow their businesses. Business owners have been very conservative in their spending and keen in their capitalization strategies both for sources and uses of funds.

Demand is definitely bouncing back in response to improving economic conditions. But the demand is soft. And small business owners need strong financial programs to support their efforts to fund inventory, bring products to market, add jobs and start businesses.

Suggestions for Improvement

The lending market needs to be there to support business owners and start-ups, to fuel economic growth. Specifically, SBA lending needs to be there for them with plain-spoken criteria, and enough funds to support smaller, non-real estate small business loans in a way that works for both the lenders and the borrowers.

Recent statements that many lenders and the SBA make about improvements in lending are white-washing the situation, and just don't tell a story that's fair to both sides. Claims of "doubling" the volume of loans, or quarter-over-quarter loan volume improvements encourage business owners to seek loans before lenders are ready and willing to fund them. Lenders are still, largely, not loaning money to the small businesses, to the start-ups, to those that create the majority of jobs in this state. Lending may be up from its dead standstill of recent months, but it's stalled at best.

The bottom line is that lenders have more money than they've ever had, with record profits. Among many other policies, their lending criteria have changed, as it should have. Yet, they have been given (or were forced to take) funds to stabilize the financial situation, and instead of moving those funds and profits through to the marketplace in the form of new loans which will stimulate the economic recovery, they have held onto those funds and the resulting profits without releasing them back into the very markets they are chartered to serve.

- **Better Lending Criteria Transparency** – Business owners spend months of their time and thousands of their own dollars preparing to expand or launch their businesses. They assume they will get a business loan because of what they've read about lending being up, or they've spoken with a lender who didn't necessarily "shoot straight" with them. Typically, they don't understand what the lender's criteria or target ratios for collateral or cash flow or credit worthiness are, or they aren't aware that all of their assets aren't eligible for collateral, etc. Lenders use industry statistics and financial ratios business owners have never heard of and don't understand, and this is foolishness. There's no reason to keep this information a secret. It doesn't make sense for business owners to waste their limited resources only to get to the end of the line and find they didn't qualify for reasons they're not told about long before the loan package even gets submitted. None of this makes sense. In recent

great Biz plans

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months I've heard story upon story from small business owners that have suffered greatly from situations like this.

- **Clean, Consistent Lending Processes and Terminology** – Lenders use terminology and criteria that borrowers don't understand. A client of mine in New York City was working with an SBA lender that was pushing them to commit to their lease so they could submit the package under the deadline for the 90% SBA guarantee. My clients fully complied with the lender's requirements and during the three month loan application process (Sept. – Nov. 2009) finally got a letter of intent, which the banker said "was as good as it gets." Under pressure from the lender to keep moving forward, they signed their lease and even started pre-construction on the space. They (and I) pursued the lender asking when the loan would process. The lender backed out of the loan in the 11th hour. This left my clients on the hook for a secured $175,000 yearly lease in Union Square plus some construction they'd started at the lender's urging – commitments they never would have made if the lender was forthcoming. All this will likely bankrupt one of the partners. My client didn't understand that a letter of intent is not a pre-approval, and that this lender's criterion for "working capital" does not include tenant improvements. Who knew? Certainly not the borrower. Certainly not me, I'd never heard of this restriction on an SBA 7A loan before. People believe what they read about increased lending and believe they are savvy and strong enough to prevail. Much of lending is a sales process, and borrowers need better protection. While the SBA.gov web site is outstanding – one of the finest resources any business owner can use – it can go further in protecting prospective borrowers. SBA information packets should provide even clearer guidelines and pre-loan training that steps up and fills in the gaps for borrowers, regardless of the diversity among SBA lenders in the different programs.
- **Expanded SBA Funding, Particularly 7A Funding** – Any recovery-focused SBA funding number that starts with "million" instead of "billion" is wholly insufficient, and geared not toward small business owners and job expansion, but toward larger businesses and lenders. Most small business borrowers won't ever qualify for the proposed limit increases or for real estate-backed loans. This is not a use of SBA funds that will benefit enough businesses to grow the economy or to add jobs. Piece-mealing the SBA funding in small packages that are good for a few months is not solving the problem; it exacerbates the problem. Lenders are comfortable putting loans through for their current clients, but not comfortable enough to expand their lending criteria because the special funding packages are relatively short-lived. This also muddies the water making it look like demand for loans is soft, when it's just more of the same. Lenders are not comfortable extending their resources because the rules of the game continue to change. A change in the lender role, their portfolio, and their criteria has shut off the supply. From both the borrower's and the lender's perspective, why go to a well when you know there's insufficient water and it ran dry on you the last time you were there?

Many thanks for this opportunity to contribute to this process.

Best regards,

Cindy Anderson

Cindy Anderson, CEO and President
Cindy@GreatBizPlans.com

Chair WARREN. Thank you, Ms. Anderson. Ms. Wiest.

STATEMENT OF CANDACE WIEST, PRESIDENT AND CEO, WEST VALLEY NATIONAL BANK

Ms. WIEST. Good morning, Madam Chair and members of the Panel.

I am the President of West Valley National Bank. We are a $39 million community bank centered in the West Valley which is one of the hardest-hit areas in the Valley. We opened at the start of the financial storm on December 21, 2006, and we were founded to serve small business, the medical and dental professionals throughout Maricopa County.

Our main focus, though, continues to be in the West Valley where approximately 95 percent of the businesses, according to our opening research, were small businesses.

In 2007 we realized that there was about to be an economic hailstorm and we went out and doubled our capital, believing that we would be in a much stronger position to provide opportunities for small businesses or also for bank acquisitions. We did utilize some of those funds to go into Buckeye. We felt a little like the firemen at 9–1–1 going into the hardest hit area out there where the banks were pulling back.

In 2008 we sought SBA approval so that we could continue to start funding more small business loans and in 2009 we did fund three SBA 504 loans and recently, in fact just a week ago, closed our first 7(a) loan. So we're very excited about that.

The government increase in SBA funds, combined with the 90 percent guarantee in waiver of fees, has been extremely helpful, both from the bank and the client standpoint. It provides us a much lower risk loan which you've heard a lot of testimony about the condition of community banks and even though we are not in that bucket, certainly it has been important to us to be able to originate quality loans just because of the amount of scrutiny.

The question of market demand, I think, is complex. The locally-owned community banks control less than 4 percent of the market share of deposits. Unlike states like Georgia and Florida, who have several hundred community banks, I think right now there are 25 in this state and that is it. So that is also, I think, an issue out there for small businesses.

We could expand. We have 39 percent Tier 1 capital and 50 percent leveraged capital. We have looked at a lot of borrowers. I think last year we looked at somewhere around $250 million in new credit and found that many of the borrowers were in a start-up situation which is, I think, considered highly risky for a small community bank like ours.

We've also found a number of people who didn't cash flow when you look at debt service coverage ability of one to one and we certainly found that collateral was impacted and that's why the SBA loan status was critical for us and I do want to say that I think they have been fabulous. Our last loan turned around in less than one week because we do not have preferred lender status there.

The real issue is, as you've heard over and over, the real estate loans. We chose not to leverage up in 2007 because we saw this decline coming. So we didn't do as much real estate because for every

one percent the cap rates go up, the value drops by 15 percent. So you could almost bet that if cap rates went up even 2 percent you'd be looking at a problem loan. So we did not do that.

Unfortunately, we are not profitable and I think the only thing that is going to cure that for us—it's not from loan losses, it's really strictly from the ability to source quality borrowers.

The regulatory environment has had an impact on us. It's not from the standpoint of affecting our lending decisions but just from a pure oversight compared to the manpower. We have 11 employees. Right now the OCC is in our bank. When, in 2008, they finished a full scope of safety and soundness, they were in our bank for a month, two weeks with the training team, there were 10 of them, 11 of us. In 2009 they had been in our bank at year-end 2008, they were in, we had a BSA exam, a fair lending exam, and a CRA exam.

[The prepared statement of Ms. Wiest follows:]

CANDACE WIEST
PRESIDENT AND CEO
WEST VALLEY NATIONAL BANK
April 27, 2010

TESTIMONY TO THE TARP CONGRESSIONAL OVERSIGHT PANEL

I. DESCRIPTION OF WEST VALLEY NATIONAL BANK

West Valley National Bank is a $39,000,000 community bank. We were founded by a group of local businessmen and farm families who believed the market was underserved. We raised our initial capital from 150 local shareholders in three weeks. We opened our doors on December 21, 2006. We are the only locally owned bank West of I-17 founded to serve the small businesses and medical and dental professionals throughout Maricopa County. Our main focus however is in the cities most hard hit by the recession; Avondale, Glendale, Goodyear, Buckeye, and Tolleson. According to our preopening research approximately 95% of the businesses in these cities meet the government definition of small business. In 2007 we doubled our capital because we believed the recessionary market would provide opportunities. Again, it was all from local investors and we raised the funds in a month. We utilized some of those funds to open a new branch in Buckeye, one of the hardest hit cities. We continue to focus on serving those markets. In 2008 we received SBA approval to originate loans. Given the impact of the financial crisis in this state, we felt SBA lending would be critical going forward. In 2009 we funded two new SBA 504 loans and recently closed our first 7A loan. The government increase in SBA funds, combined with the 90% guaranty and waiver of fees has allowed us to expand our pipeline considerably since year end 2009.

II. MARKET CONDITIONS/LOAN DEMAND

The question of demand is difficult. WVNB certainly has room to expand lending, given that we have 39% Tier 1 capital and almost 50% leverage capital. Explained another way, we have originated $25,000,000 in loans and still have $16,000,000 in capital. We could grow the Bank by $100,000,000 in new assets and not need any new capital.

Our lack of loan growth is a reflection of the impact of the recession on the small businesses in this state. While the rest of the country has experienced varying degrees of recession, I believe Arizona has been functioning in a depression. In my opinion, real unemployment could be closer to 15% in this market. Land values have dropped by 85% since 2006 and residential property values have decreased by 50%. Currently there is almost 1,000,000 square feet of vacant commercial real estate. The crisis has also been exacerbated by the lack of credit in this state. The three largest institutions in the country control 70% of the deposits in this state. I have heard anecdotal information that many homeowners and small business owners who depended upon equity lines and credit cards have seen spikes in credit card rates and equity lines frozen. All of those issues lead to difficulties in finding credit worthy borrowers. As a result, we have not met our lending projections. Last year we funded approximately $10,000,000 in new credits. We would do more, but it is difficult to find anyone who has not been impacted and remains

creditworthy. We continue to work with the Small Business Association, GPEC, Westmarc, and the economic development offices of the west valley to provide capital to small businesses.

III. TARP MONEY

We did not take TARP money. As a small institution, we would have only been eligible to receive less than a $1,000,000. Fortunately we had the foresight to raise additional capital at the end of 2007 which we had not deployed. However, at the time TARP funds were available we applied because we felt the market might provide a relatively new bank with few asset quality issues an opportunity. At the time there were few details available as to the conditions imposed by the government. As our application was processing, we saw new conditions being added daily and witnessed the growing stigma being directed at TARP banks. Because we did not want to enter into an agreement with a government who could alter the terms at any time, we chose to withdraw our application.

In retrospect, we feel this was the right decision. In my opinion, this administration and Congress has done a poor job of explaining the purpose of the TARP funds to the citizens. If we decline a loan, many of us have heard some version of "Congress bailed you out so you could make loans to people like me." There is real public anger to learn that banks used the TARP funds to realign their balance sheet by dumping problem loans rather than lending to small businesses.

There is also the perception that the government cannot be trusted to live with the agreements they make relevant to TARP funding for Banks. I understand that the TARP program was developed during a period of crisis. However, changing or adding conditions after the funds were accepted has also created the perception you cannot trust the government.

III. THE SMALL BUSINESS LENDING FUND

As for the proposed Small Business Lending Fund, if I understand it as proposed, I do not believe it will benefit the banks or small businesses owners or the following reasons:

- No matter what you call it, the public will continue to see this program as a bailout unless there is a requirement (and accountability) for Banks to use the funds specifically for lending to small businesses and not to restructure their balance sheet.
- The size of institution eligible for these funds is too large. These are the same institutions that have access to public markets for capital but chose TARP because the cost of capital is cheaper than market costs. In addition, only the same Banks who qualified before will qualify again.
- Each Banks primarily regulator controls the application process. Congress needs to provide specific guidelines as to the qualifications to be approved so the approval process is driven by transparent criteria.
- The conditions must also be transparent and permanent. As a twenty two year lender, I have never been legally able to amend loan terms midstream. That same rule should apply to new funds.

- And finally, in my humble opinion if the goal is truly to stimulate lending to small business the taxpayers of this country would be better served if the funds were given to the SBA who already has a proven distribution structure and infrastructure.

Candace Hunter Wiest is the founding President of West Valley National Bank. She has been a community bank President since 1993, serving previously as the CEO of Inland Empire National Bank. She served as a Director on the Board of the San Francisco Federal Reserve from 2001 to 2008. She is the first woman elected as a Class A Director in the Banks history. Ms. Wiest believes in community service. She is a trustee of Franklin Pierce University, the Secretary of the Board of Western Region Medical Center CTCA, on the Board of the Greater Phoenix Economic Council, the incoming Chair of Westmarc, the Chair of Mayor Roger's Ad Hoc Economic Development Committee, and a member of the West Valley Advisory Board for Phoenix Children's Hospital. Ms. Wiest has received numerous community awards and recognition, including the Stevie Award for best Executive in 2010.

Chair WARREN. Thank you, Ms. Wiest. And we will have all of your written statement in the record, as we will for everyone.

Mr. Smiley.

STATEMENT OF PAUL SMILEY, PRESIDENT AND CEO, SONORAN TECHNOLOGY AND PROFESSIONAL SERVICES

Mr. SMILEY. Ms. Warren, members of the Panel, thanks for having me this morning.

My name is Paul Smiley. I'm a retired Air Force lieutenant colonel and combat veteran. I am also the President and CEO of Sonoran Technology and Professional Services.

Sonoran Technology and Professional Services is an SBA-certified 8(a) and service-disabled, veteran-owned small business that provides professional services in the federal market arena. We specialize in a variety of services that include but are not limited to military training operations, leadership training, information technology, help desk services, call center support, facility management, logistics support, accounting, and office administration.

The strength of our company lies in our ability to deliver low-risk, best value, and transformational services to the Government. Moreover, Sonoran has a unique ability to recruit and retain highly-qualified and experienced personnel and professionals for the Government who have security clearances.

Since 2007, Sonoran has grown by 700 percent and expanded our operations to six states and maintained a 96 percent retention rate. Although not publicly acknowledged until December 2008 that the United States was in the midst of the worst recession since 1932, Sonoran Technology has not only managed to survive but we have grown by 700 percent since winning our first government contract in July 2007.

Like a majority of other small businesses, the major obstacle we faced then and, to a certain degree, today is access to working capital to support new employee payroll. It is my opinion that, due to the financial crisis, increased regulatory oversight, and, to a large degree, banks painting small businesses with the small broad brush, those of us with proven business track records of success and whose financials are strong still have a difficult time obtaining capital to grow our businesses and put Americans back to work.

This broad brush approach fails to recognize small businesses like Sonoran Technology, which operate in a market that has monthly receivables that are guaranteed and consistent and guaranteed by the Federal Government. Moreover, as an SBA-certified 8(a) small business, program certification requirements and orders are far more stringent than any bank will require for a small business.

In fact, if more banks understood federal contracting and how it works, I believe you would see an upsurge in small business lending and companies like Sonoran Technology would have not been rejected by five banks.

There is, however, a good news story here today. In July 2008 I was able to prove to Ms. Candace Wiest, the CEO of West Valley National Bank, that Sonoran Technology was creditworthy and very low risk. In July 2009, after winning a $3 million contract with the Air Force, Ms. Lisa McCarthy, Vice President of Arizona

Business Bank, took the time to understand our company business model and we were able to obtain a Patriot Express Line of Credit and able to hire 20 new employees and to compete for several multimillion dollar contracts which we are competing for today.

Without the cooperation and understanding of Ms. Wiest and Ms. McCarthy, Sonoran Technology may not be in business today.

I am convinced that during the past two years there could have been a lot more small business success stories had there not been a lack of access to capital.

[The prepared statement of Mr. Smiley follows:]

Congressional Oversight Panel Testimony

Paul Smiley, Sonoran Technology & Professional Services

Sonoran Technology and Professional Services is an SBA certified, 8(a) and Service Disabled Veteran Owned Small Business that provides professional services in the federal market arena. We specialize in a variety of services that include, but are not limited to, military operations training, leadership training, IT help desk services, call center support, facility management, logistics support, accounting, and office administration services. Our strength lies in our ability to deliver low risk, best value, and transformational service solutions. Moreover, Sonoran has a unique ability to recruit and retain highly qualified and experienced professionals that have government security clearances. Since 2007, Sonoran has grown by 700%, expanded operations to six states, and maintained a steady 96% employment retention rate.

Although it was not publicly acknowledged until December 2008 that the United States was in the midst of the worst recession since 1932, Sonoran Technology has not only managed to survive, but has grown by 700% since winning their first Government contract in July 2007. Like a majority of small businesses, the major obstacle we faced then, and to a certain degree today, is access to working capital to support new employee payroll. It is my opinion that due to the financial crisis, increased regulatory oversight, and to a large degree, banks painting small businesses with the same "broad-brush", those of us with a proven business track record of success and whose financials are strong still have a difficult time obtaining capital to grow their business and put Americans back to work. This broad brush approach fails to recognize small businesses like Sonoran Technology which operate in a market with monthly receivables that are consistent and guaranteed by the federal government. Moreover, as an SBA certified 8(a) small business, program certification requirements and oversight are far more stringent than any bank would require. If in fact more banks understood how federal

contracting works, I believe we would see an upsurge in small business lending, and companies like Sonoran Technology would have not been rejected by five banks. There is however, a good news story. In July 2008, I was able to prove to Ms. Candace Wiest, CEO at West Valley National Bank, that our company was credit-worthy and low risk.

In July 2009, after winning a $3M dollar contract with the Air Force, Ms. Lisa McCarthy, Vice President at Arizona Business Bank, took the time to understand our business model and we were able to obtain a Patriot Express line of credit to hire twenty (20) new employees and compete for several multi-million dollar contracts. Without the cooperation and understanding of Ms. Weist and Ms. McCarthy, Sonoran Technology may not be in business today. I am convinced that during the past two years, there could have been a lot more small business success stories if they had access to capital.

In conclusion, as a small business owner, the greatest joy I have is putting people back to work. Americans want to work; they want to provide the very best for their families, and being part of that experience is priceless. Any small business owner worth their salt will tell you it's a heavy responsibility knowing that the decisions you make day in and day out, could be the difference between your employees having a job or not. Conversely, it is the responsibility of our elected and Government officials to ensure the rules of commerce and access to capital are applied fairly across all businesses large and small.

Chair WARREN. Thank you, Mr. Smiley. Mr. Lundy.

STATEMENT OF JAMES H. LUNDY, PRESIDENT AND CEO, ALLIANCE BANK OF ARIZONA

Mr. LUNDY. Thank you, Chairwoman Warren and Members of the Panel, for this opportunity to speak today.

I've been a commercial banker in Phoenix for over 25 years and during that time I've spent my career basically making loans to Arizona-based businesses in virtually all businesses in Arizona within the 500-employee definition and so I have considerable experience lending to both really small businesses, such as Mr. Smiley's or those under an SBA program, and also the businesses that Mr. Silvers referred to, those with perhaps 100-to-300 employees.

I think that the Panel, in each of your statements—I was interested in those, and I think that the four of you summarized pretty well the various issues. They're complex and they're interactive and it's difficult. So I know I provided this written statement. So let me just try to summarize quickly.

I think that the Alliance Bank has run against the grain a little bit and we did grow loans in 2009 and we've grown loans in the first quarter of 2010. That's been difficult.

As relates to the specific subject of today's hearing, I would think that we would have to testify that the TARP has been helpful because we're fortunate, many community banks aren't part of a larger bank holding company structure. We're part of a small regional, I would say, and as my testimony points out, we've been able to raise $420 million in the last little over two years. $140 million of that came from the TARP. They've downstreamed about $35.5 million to us over the last 24 months and so one could say that $12 million of our capital stock came through the TARP and then it's also true that we have expanded our lending when many banks have not. So I think from that perspective, the TARP has been helpful.

I would like to comment a little bit on some of the things that I think we could do to improve things. I was the one that mentioned, Mr. McWatters, the phase-in capital requirements. I think—and I would agree with Mr. Silvers. I basically think that one of the things that we all should have learned from this crisis, bankers, policy-makers, Congress, the regulators—I do think that probably the banking industry needs more capital, but I do think, as I say in here, that we ought to phase those capital requirements in strategically over the next two to three years.

I think it's difficult at the moment, though. Our bank, as I say in my testimony, has had better credit quality metrics than most in a very difficult environment, but they're still not great. We lost money last year, primarily due to charge-offs. We made money the first quarter and I'm hopeful that that trend will continue.

But I do think that, understandably so, people are concerned about safety and soundness of banks and so there is tremendous pressure from all sources to have banks raise their capital as a buffer against problem loans—but that's an issue that I think is difficult.

I think the other——

Chair WARREN. Mr. Lundy, I'm going to stop you right there.

Mr. LUNDY. I'm sorry.

Chair WARREN. That's all right. We have your written testimony. Thank you. I want to save time for us to ask questions.

[The prepared statement of Mr. Lundy follows:]

TO: **Congressional Oversight Panel for Troubled Asset Relief Program (TARP) – Elizabeth Warren, Chair**

FROM: **James H. Lundy, President/CEO of Alliance Bank of Arizona (Alliance Bank)**

RE: **A community banker perspective on the impact of the economic recession on small business loan demand and credit availability in Arizona and the efficacy of current and proposed TARP initiatives on encouraging small business lending.**

DATE: **April 27, 2010**

I. Alliance Bank Profile

Alliance Bank is a state-chartered bank which opened for business in February 2003. As of 3/31/10, Alliance had $1.370 billion in total assets, $1.237 billion in deposits and $783 million in loans. It operates out of ten offices and serves Arizona's two primary population areas (Greater Phoenix and Tucson), as well as the northern Arizona communities of Flagstaff, Sedona and Village of Oak Creek. Alliance is primarily focused on delivering commercial banking products to Arizona based businesses as well as retail banking services to the owners and employees of its business customers and other individuals seeking a personalized banking relationship. With $984 million in deposits at year end 2009, Alliance controlled approximately 1.3% of Arizona's deposits, placing it third among Arizona-based banks in deposit share and 11th overall out of some 80 banking institutions operating in Arizona. (In Arizona, three large national banks, JP Morgan Chase, Wells Fargo and Bank of America, control approximately 70% of all deposits.)

Alliance Bank is a wholly owned subsidiary of Western Alliance Bancorporation, a five bank western regional banking holding company with headquarters in Las Vegas, Nevada. As of 12/31/09, Western Alliance had total assets of $5.8 billion, deposits of $4.7 billion and loans of $4.1 billion, ranking it 88th in size out of 520 publicly held banking companies in the United States.

II. Description of Alliance Bank's loan composition.

A. Alliance Bank focuses its lending efforts almost entirely within the state of Arizona, responding to the commercial and industrial (C&I) and commercial real estate borrowing needs of local business owners and professionals. As of December 31, 2009, the Bank's loan portfolio was composed as follows:

		$ in million Outstandings
C & I Loans & Leases		190
Commercial Real Estate (owner occupied)		209
Commercial Real Estate (construction & land)		104
Commercial Real Estate (investor term loans)		138
Residential RE & Consumer, all types		104
	Total	$ 745
Total # of loan customers	1,363	
Average loan size	$547,000	

B. Meeting the needs of the local community (CRA Statistics):

The table below displays a distribution of the Bank's loans made from January 2007 through December 31, 2009 which meet the definition of "small business loans" for purposes of CRA assessment.

	Number of Loans				Loan Amount (in 000's)				
	Inside primary service area		Outside primary service area		Inside primary service area		Outside primary service area		Total
	#	%	#	%	$	%	$	%	$
2007	387	97	11	3	96,585	96	4,168	4	100,753
2008	380	97	12	3	98,856	93	7,271	7	106,127
2009	375	97	13	3	90,283	95	4,364	5	94,647
Total	1,142	97	36	3	285,724	95	15,803	5	301,527

Additionally, as shown in the table below, Alliance Bank has made over $35 million in loans over the past three years which were $1 million or more and met the definition of "Community Development Loans" for CRA purposes.

Community Development Loans:

Year	Dollar	Number
2007	$10,868,000	6
2008	$11,198,500	6
2009	$13,165,090	11
Total	**$35,231,590**	**23**

C. Loan Quality comparisons to national, regional and Arizona peers.

Alliance Bank has generated significant loan growth during its seven year history. Even so, the Bank's loan quality and performance statistics compare favorably with peers given the severity of the recession in Arizona.

	% of (NPAs + 90 Past Due) to Total Assets	% of Net Charge-offs to Average Loans	Texas Ratio*
All US Banks	3.1%	1.8%	27.0%
All Western Banks	4.7%	5.6%	38.9%
All Arizona Based Banks	5.8%	3.7%	55.0%
Alliance Bank	**2.4%**	**2.1%**	**31.0%**

* The **Texas Ratio** is commonly used to measure the severity of a bank's credit problems in relation to its capital. It is calculated by dividing non-performing assets and loans 90 days or more past due by its common equity capital and loan loss reserve. The lower the number the better. Historically, a Texas ratio

above 100% has been a warning sign. For example, the average Texas ratio for the 6 Arizona banks which have failed since 2008 was 233% in the quarter before they were closed.

III. Impact of TARP on Alliance Bank's access to capital during 2008 and 2009 and the corollary impact of TARP on the ability of Alliance Bank to fund loans to Arizona based businesses.

Alliance Bank's parent, Western Alliance Bancorporation (WAL), raised significant new capital during 2008 & 2009, as follows:

	Amount (in $ MM)	Source
2nd Quarter 2008	$30 MM	Private Equity Offering
3rd Quarter 2008	$50 MM	Private Equity Offering
4th Quarter 2008	$140 MM	TARP Funds
2nd Quarter 2009	$200 MM	Public Stock Offering

Total Capital Raised = $420 million
% of Total from TARP = 35%

WAL, in turn, has made $35.5 million in capital injections into Alliance Bank from 1/1/08 until 3/31/10, so $12 million or 35% of the capital Alliance has received over the past 2 ½ years had its source in TARP. Alliance Bank has maintained its leverage capital ratio at 6% or higher which is 1% above the threshold required to be considered "well capitalized" by federal banking regulations. This capital position, coupled with asset quality statistics that are above market peer, have supported the Bank's ability to continue to generate loan growth in an extremely difficult environment, as is illustrated below:

	12/31/07	12/31/08	12/31/09	03/31/10
Loan Outstandings	$584MM	$678 MM	$745MM	$783MM
$ and % Growth		$94MM – 16%	$67MM – 10%	$38MM – 20%

BY CONTRAST, THE TOTAL LOANS OUTSTANDING FROM ALL ARIZONA BASED BANKS DROPPED BY $52 MILLION BETWEEN 12/31/08 AND 12/31/09.

While Alliance Bank of Arizona is running against industry norms and adding net loan growth when many banks are not, I don't want to leave the impression that this is not an extremely difficult lending environment. The recession has sharply decreased loan demand from many Arizona businesses. Every bank portfolio experiences normal runoff, and, in this environment, a higher level of charge-offs than normal. Thus, increasing loan outstandings in the current environment is quite challenging. Considered in combination with requests from regulators for more capital and the heavy emphasis on rapidly reducing real estate concentrations it is no surprise that loan totals are shrinking at many banks.

IV. Suggestions for encouraging increased lending to small business by banks doing business in Arizona.

A. Phase-In Increased Capital Requirements:

Through formal and informal enforcement actions, regulators have effectively increased the capital requirements for banks. These actions are pro-cyclical and, in the current climate, have the effect of discouraging lending. Increased capital requirements for the banking industry may make sense, particularly for banks with higher risk profiles. However, increased capital requirements should be phased in, perhaps over a two to four year period, allowing the industry to deal with capital issues more strategically. (This need not interfere with appropriate actions related to capital shortfall at banks facing imminent failure in the absence of additional capital.) Additionally, another comment on capital is appropriate. Tier I risk based capital, which incorporates a portion of the Bank's loan loss reserve within its calculation, was designed to give banks some "capital credit" for

adequately planning for future loan losses. In the current environment, Tier I risk based capital levels seem to carry less weight with regulators. Moreover, with loan loss reserves nationally running over 2%, banks have taken the hit to earnings and capital through "beefed up" reserves but receive limited credit for these increased reserves in their capital calculations. The regulatory community appears to be paying less attention to this specific view of capital as an analytical tool in the current environment when, in fact, this method of looking at capital was envisioned as an appropriate measure to analyze bank health in a stressed credit cycle.

B. Build more flexibility into the regulatory playbook.

The swiftness and depth of the financial crisis caught everyone off guard and it is not surprising that bank regulators are under strong pressure to enhance their oversight activities. Regulatory resources might be better utilized to focus more attention on banks with high levels of non-performing assets and other danger metrics. Despite the number of bank closures during the past 30 months (215 as of 4/16/10), more than 700 banks remain on the FDIC "problem" bank list. My colleague, Candace Wiest, President/CEO of West Valley National Bank, can speak eloquently as to the level of scrutiny and manpower expanded on her very small bank during this past year by her bank's regulators. A new playbook which encourages the banks' regulators to do more frequent "short reviews" with banks with better asset quality and liquidity metrics and expend more of their resources on banks which are most likely to fail might bring about faster resolution of problem institutions. Regulators are stretched very thin but seem to have too little flexibility in their examination procedures and process which exacerbates their resource shortage.

C. Differentiate real estate concentration issues depending on the date of loan origination.

There seems to be little differentiation for loans made in 2004, 2005 or 2006 when values were peaking as opposed to loans made in 2008 or later when values had declined sharply. Virtually every community bank in the Western U.S. has significant real estate concentrations. The message by regulators to reduce these concentrations is loud and clear. However, the failure to differentiate the risk associated with a real estate loan made in 2006 versus one made in 2009 from a concentration standpoint, works to discourage banks from making new real estate loans, particularly when combined with the request to raise more capital immediately, or failing that, to aggressively shrink bank balance sheets in order to raise capital percentages.

D. More balance in the compliance area.

The compliance aspect of examinations has become increasingly difficult for community banks. While Congress and the Administration debate how to better regulate Wall Street/investment banking activities and also discuss how to effectively include myriad "shadow banking" players within meaningful regulatory oversight, compliance exams at community banks have become much more difficult. Having been a community banker in Arizona for 25 years and having worked in a range of banks during that timeframe I can attest that most commercial banks take their compliance responsibilities very seriously. Banking regulations are complex and are constantly changing but we try very hard to get it right. Recently, compliance exams have an increasingly hard edge to them which, to the community banker, is frustrating because community banks in the aggregate, had very little to do with subprime lending or the various housing bubble excesses with which we are now all too familiar. When combined with all the other issues facing banks today (i.e. capital, loan quality problems, liquidity challenges, etc), the regulatory posture that somehow community banks are short changing consumers on the compliance front seems unwarranted and difficult to understand.

V. Specific comments on the potential of $30 billion of additional TARP funds proposed as a source of capital for community banks as a means to encourage lending to small businesses.

Over the past two years, through its parent, Alliance has benefited from $35.5 million in capital infusions, 35% which came from TARP. Alliance Bank has continued to expand its loans to small businesses when many banks have not. For example, Alliance Bank has funded $38MM in net loan growth in the first quarter of this year, accompanied by very strong deposit growth (over $200MM) attributable to a new relationship with an Arizona municipality. As noted above, we recently received a $5.5MM capital infusion from our parent which has enabled Alliance to continue to maintain a 6% capital level, 1% above the "well capitalized" threshold. Without this access to capital from our parent, about 1/3 of which can be attributed to TARP, it would have been more difficult to support this growth in our balance sheet.

Alliance's experience suggests, at least conceptually, that making an additional source of capital available to community banks has the potential to encourage them to do more lending. However, at this point in the cycle, there may be other measures, which could be implemented more easily. For example, the Small Business Administration (SBA) has a well developed program supporting community bank lending to small businesses. If a significant portion of the $30 billion were earmarked to expand support to the SBA, perhaps by permitting the 7(a) or 504 programs to include refinance of existing loans in appropriate circumstances, or increasing the guarantee levels to 90% from 75% for the next two years, or expanding the revenue and number of employee restrictions for SBA eligibility now in place....all of these suggestions might have a more immediate positive impact on local business lending rather than a new version of TARP.

VI. Conclusion:

Community banks play a critical role in supporting local businesses which are the key to any local economy. It is important that a healthy local banking sector survive the current financial crisis not only in Arizona but across the country. If additional TARP funds are to be made available to community banks it needs to be done soon. We are at a point in the cycle when prudent lending to small business needs to be encouraged and any program with a long lead time may arrive after the ship has left the dock. In the interim there are several steps that could be an immediate spur to increased small business lending by community banks:

- A "phased-in" approach to increased capital requirements
- More flexibility with regard to real estate concentration issues
- More regulatory focus on banks with high levels of non-performing assets with a goal of swifter resolution of "problem" banks
- More regulatory flexibility with respect to examination scope at relatively healthy banks
- Expansion of existing SBA programs
- More measured compliance examinations

I look forward to discussing these and other ideas with the committee.

Respectfully submitted,

James H. Lundy
President/CEO

JHL/jrm

Chair WARREN. Ms. Darling.

STATEMENT OF MARY DARLING, CEO, DARLING ENVIRONMENTAL AND SURVEYING

Ms. DARLING. Thank you, Madam Chair and Members of the Panel.

I'm very honored to be here today. Darling Environmental and Surveying is a small, woman-owned business. We provide high-tech, avatar-style 3–D surveying to engineers and architects that design in 3–D.

I agree 100 percent that small business will be left behind unless we break the stalemate with the banks. We are very creditworthy, as I said. We have been under-capitalized since we started the company. We hired our first CFO in 2008 and he saw that as the biggest problem. He helped get our banking books together in a way that we could go to each bank very professionally.

We were turned down 100 percent of the time in Tucson. We actually ended up getting a bank in Phoenix that understood business banking, Bank of Arizona, and finally, in mid 2009, got our finances in order.

However, as soon as the TARP funding became available and we saw what was in the newspapers about SBA loans, in February and March of 2009, we tried hard to get SBA loans. We were told by every bank that SBA told us to go to that even though we read SBA loans were not asset-based loans, we were turned down. Every bank said that's what you read but in reality SBA loans are asset-based. So unless we had commercial real estate, we were told we were not going to get an SBA 7(a).

So we slashed expenses. We rode out the fact that clients went bankrupt and didn't pay us. We cut employee numbers. We had the one loan from Bank of Arizona that held us through and now we're in a position where we're really building our business in that we have more clients than ever. We have a fabulous service that we're offering and yet we are at that point where we're going to need lending and our past experience shows that banks are going to ask for three years of our taxes and personal guarantees and they're going to look at 2009, even though it was an anomaly, and we're going to be denied the funding we need to grow our business.

I think it's a very big concern for a lot of small businesses, not just mine. I'm a member of the National Association of Women Business Owners, and I'm talking with a lot of other women with the same problem. So I'm very excited to know that you're here and that you're addressing this issue.

Thank you.

[The prepared statement of Ms. Darling follows:]

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April 22, 2010

Thank you for the opportunity to provide my written statement and testimony at the field hearing to take place on Tuesday, April 27, 2010 in Phoenix, Arizona concerning the impacts of the TARP legislation on Arizona small businesses.

Background

- I am the owner and operator of an established and profitable Arizona-based small business and have been in business for over 13 years;
- I access credit via traditional bank loans from local financial institutions;
- I have what I believe is an interesting perspective and story to tell on how the financial crises has impacted my ability to access credit from these sources on the same terms despite being in good standing with all my creditors and
- My business is not dependent on the construction or real estate industry.

I started my environmental permitting company in 1996. In 1997 I expanded to add land surveying services. In 2002 I again expanded by adding high definition 3D laser scanning to the company's list of services. The company had increased revenue every year until 2009 (see chart below), then our revenue decreased 50% from that of the 2008 ($1.2 million in 2009 verse $2.4 million in 2008). The company is now in a conservative growth phase with projected revenues of $1.8 million for 2010 (included in chart below).

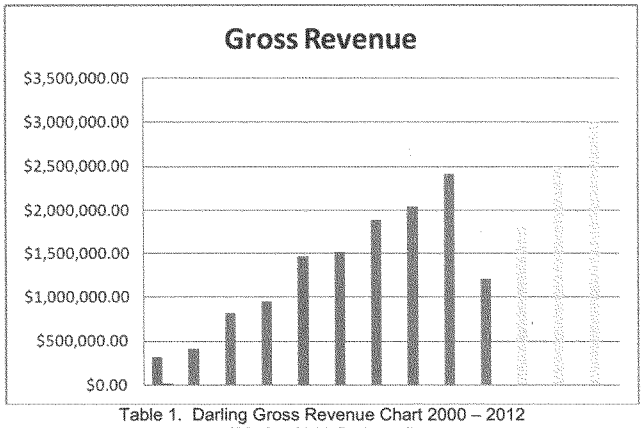

Table 1. Darling Gross Revenue Chart 2000 – 2012
(2010 – 2010 Projected)

- Though my company had this 50% decrease in revenue between 2008 and 2009 it was impossible to decrease expenses 50% unless I declared bankruptcy. Our office rent, equipment loans, vehicle loans, vacation owed to employees, health care, professional insurance, and other critical elements remained constant or increased in 2009. We had legally binding contracts for these items.
- I hired a debt negotiator and was successful in temporarily reducing rent for 9 months, but I am now legally obligated to make up the rent reduction with higher monthly payments in the remainder of 2010.
- The debt negotiator was not successful in reducing loan payments on vehicles and his attempts to renegotiate equipment loans were insignificant.
- I could not to sell vehicles and equipment because we could not find buyers to pay the amount we owed.
- I increased debt by over 83% on our lines of credit to cover losses.

Problems:

1. I decreased wages and benefits to employees (20% less pay when non-billable, no vacation or sick leave accrual, virtually no training or non-billable travel). We now need to hire more employees but we have a reduced benefit package and moderate wages, so we are not able to hire the qualified people we need.

2. I increased debt and am now paying over $4,000 per month in interest (almost twice as much as 2008, with only ½ the revenue of 2008).

3. Any increases in interest rates will limit my ability to make the company profitable. Several loans are tied to prime interest rates and need to be paid back before inflation makes it impossible.

4. Our major credit card lenders – American Express and Chase Bank have cut our credit limits over 33% and 75% respectively, in spite of the fact that we have a 100% perfect record of payment. (American Express reduced credit from $81,900 in February 2009 to $57,900 in February 2010 and Chase reduced credit from $76,200 in February 2009 to $19,600 in February 2010). Most of these reductions occurred in early February 2010 just before the 2010 Credit Card Act took effect.

5. Each time I pay down my American Express Business Management Card balance so our employees can travel to out of town jobs, American Express reduces my credit limit accordingly. This is happening in spite of the fact that my credit rating is 766 and I pay at least double the minimum payment before it is due each month.

6 Lenders (Chase, Vantage West, CIT, and M& I Banks) refused to lend to my business in 2009/2010.

Wells Fargo, Bank of the West, Compass Bank, and Bank of Arizona have all denied increased in my existing business loans.

Thus, I cannot grow except by revenues and need to include service of debt (incurred primarily in 2009).

7. We are now at the beginning of an upward business cycle where my business should get back to normal. This will require me to invest more in working capital as we build back our revenue base from $1.2 million to $2 plus million over the coming years. However, I had to leverage my business to survive the recession and the banks are now unwilling to lend. I need the bank's help now more than ever if I am to handle this growth. It seems counterintuitive that now, when my risk profile is greatly reduced and the outlook for my business is substantially improved, the banks don't lend. View this against the backdrop of the guarantees banks receive for SBA loans (90%) it seems even more absurd. I feel that the recession was like a hurricane and we are now in the eye of the storm. I survived the first wave of the storm and now I need to brace for the second wave.

8. My conservative business capital asset requirements for 2010 – 2011 are approximately $500,000 as follows:

- Leica HD Scanner C10 $120K
- Leica 6001 Scanner $100K
- 7 licenses Cyclone Model & Register: $120K
- Precision Target Poles $ 20K
- ACAD Revit (2) $10K
- ACAD MEP (2)$ $ 10K
- 3D Re-shaper Surfacing Software$ $ 15K
- 2 GPS systems $ 80k
- Robotic Total station $ 50k

The future of small business depends on financial institutions. Lenders need people more adept at assessing business finances. Most bankers we met with were actually very familiar with asset based lending such as the housing market. They were not familiar with EBITDA and other financial business terms. By using an accelerated depreciation rate of 50% for tax purposes on our expensive state-of-the-art 3D scanning equipment, we have over $1 million in accumulated depreciation on our balance sheet. In discussions with the majority of bankers, they used this depreciation figure as if it was a financial "loss" though it is actually only a paper loss. The scanning equipment we purchased in 2002 is still a valuable tool though it has been amortized to zero.

We are a family oriented company. In the past five years we have hired three young men that were single. All have since married, bought houses and had children. These families depend on our small business for their livelihood. The technical skills they acquired have led to their ability to work for our Nations most important industries. Their clients include Raytheon Missile Systems, Ford Motor Company, NASA, Freeport McMoRan, and National Geographic.

Our company will thrive and prosper after a low fixed interest consolidation loan and an increase in working capital.

Sincerely,

/s/ *Mary E. Darling*
Mary E. Darling
CEO and Principal Owner
Darling Environmental & Surveying, Ltd.

Chair WARREN. Thank you. Thank you very much.

Ms. Herndon.

STATEMENT OF LYNNE B. HERNDON, PHOENIX CITY PRESIDENT, BBVA COMPASS

Ms. HERNDON. Thank you for having me here today. My name is Lynne Herndon, and I'm the City President for BBVA Compass.

I, too, am fortunate to work for a bank that was able to loan money through 2009 and also in the first quarter of 2010. It certainly has not been an easy environment to loan money in. I think all of us, all the bankers at the table, understand and appreciate the purpose of regulatory bodies and the policies, but we also are struggling to try to continue to foster new loan production while, I think, keeping as many of our customers as we can in business and continuing to extend credit.

Phoenix, more so than a lot of other cities, has experienced a complete fallout in the real estate market that does make it a little bit more difficult to recover from, if you compare it to other cities, and so, as we work with our regulators and work through exams, I do believe, as a bank, that we are trying to work with our borrowers, find out their needs and give guidance, if you will, to borrowers as to what it does take to be conventionally financed.

Some of the constraints that we face, and I'll mention just a couple examples to be a little more specific, are—and it does keep going back to the capital issue, we can't ignore that. As borrowers, you know, experienced maybe a loss in 2008 but definitely a loss in 2009, we have to rate the performance of those companies. We have to acknowledge it.

Obviously as credit becomes watched, it requires more capital. From a real estate perspective, interpreting the laws of FIRREA and trying to understand whether we have to get an appraisal solely because the economy has declined or only when we're looking at a renewal or maturity. Our bank right now has a question in to the examiners asking for some rulings on that.

Our preference would be to opt for cash flow, look for cash flow first, look for the performance in a company that shows that the company's going to be a survivor and possibly not be constrained, if you will, by having to get an appraisal, even though there's not a maturity or renewal in place.

But if we do have to get that, we are forced to possibly rate that loan as a high loan to value transaction, again requiring more capital. So I know we've talked about a lot of this today.

My message to you is I do think banks are in the business to loan money. We want to do that. We want to support our communities. Yes, we are having to balance the rules and the regulations of what our regulatory bodies want us to do, but I do think we're trying to find the ways that we can to leave the money and leave the access to capital out there where possible.

It is our responsibility, I think, to talk about creditworthiness. I think to use the SBA—we are a preferred lender—we use the SBA in start-up situations or in situations where we can't quite qualify our borrower to be banked conventionally. They're a great partner. I think we will continue to use them, but it's my personal goal to make as many conventional loans to business owners in this com-

munity as we can meet and discuss and talk about good credit loans to.

Thank you.

[The prepared statement of Ms. Herndon follows:]

DATE: **April 25, 2010**

TO: **Congressional Oversight Panel for TARP**
Elizabeth Warren – Chair

FROM: **Lynne B. Herndon**
Phoenix City President of BBVA Compass

RE: **Testimony on the Impact of the Recession on Small Business Loan Demand**

I. BBVA Compass Bank Profile

BBVA Compass began its banking operations in the United States as Compass Bank. Compass was founded in 1964 and headquartered in Birmingham, Alabama. At inception, Compass was primarily a Southeastern regional bank but later expanded into Texas and further west into Arizona with operations across the "Sunbelt" states. BBVA, headquartered in Madrid, Spain, acquired Compass Bank in 2008. Having already owned smaller banks in the United States, these BBVA bank operations were merged into BBVA Compass. BBVA, our parent company, has over $750 Billion in assets and is the 7th largest bank in the world by market capitalization.

BBVA Compass in the United States has approximately $85 Billion in assets today. Our Tier I Capital ratio is 10.86% and our Leverage ratio is 8.20%. While our non-performing and charge-off trends are higher than historical numbers, we are below our peer group. This performance coupled with capital injections from our parent has enabled BBVA Compass to continue to loan money to business owners throughout 2008, 2009 and 1st quarter 2010.

Retail, Wealth Management and Commercial Lending operations all contribute to the total bank results for Phoenix. As of 3/31/2010, Total Loans for all three business segments in Phoenix, Arizona totaled $1.6 Billion and Total Deposits totaled $1.8 Billion. BBVA Compass ranks 6th in deposit share with 2.54% share in Phoenix. It should be noted that almost 70% of the deposit market share is held by Bank of America, Wells Fargo and Chase. BBVA Compass has 49 branches or 5.11% market share in Phoenix.

BBVA Compass also has bank operations in Tucson, Flagstaff, Prescott and Payson. Branches in these cities coupled with branches in Phoenix give BBVA Compass a total of 77 branches in Arizona. Total Loans from these cities aggregate over $700 Million.

Currently, the Commercial and Industrial portfolio in Phoenix has 2,394 loans totaling $647Million: Loans less than $250,000 - 1,879 loans totaling $78 Million; Loans greater than $250,000 – 515 loans totaling $569 Million.

II. Market Conditions / Loan Demand

BBVA Compass has a commercial bank focus. Market entry is determined by cities with strong population and business growth. As one looks across our footprint, targeted cities were Phoenix, Denver, Dallas, Houston, Birmingham and Jacksonville, all due to favorable population and business trends. BBVA Compass is a preferred SBA Lender and has had strong business loan growth with the SBA programs.

BBVA Compass offers working capital lines of credit, equipment loans and owner occupied real estate loans to businesses. In addition, BBVA Compass looks to offer banking products to owners, officers and employees of these businesses. We are traditionally a recourse bank and utilize the SBA to enhance loans requests to under-capitalized or start-up companies.

Clearly, the demand for loans was greater in 2005, 2006 and 2007. The escalation of the real estate market in Phoenix brought tremendous growth to feeder businesses in the construction industry. Existing businesses grew and newly formed businesses emerged. As a result, competition among the banks increased with structure and pricing becoming more aggressive. Phoenix experienced unprecedented real estate appreciation, and businesses experienced unprecedented profitability. Unfortunately, both of these trends could not be sustained long-term.

In the 4th Quarter of 2008, business owners experienced a dramatic halt in revenues. During this quarter and in 2009, business owners struggled to reset the expense structures of their companies in response to the 50 - 75% reduction in top line revenues. Liquidity and capital were drained as businesses needed excess reserves to fund losses. Companies put expansion plans on hold and tried to curb borrowing where possible. Loan demand dropped dramatically during this period.

BBVA Compass continued to make business loans during 2008 and 2009 and is doing so currently. While the bank's structure and terms were similar to previous years, it was and is challenging to underwrite borrowers in the current economic environment. Most companies recorded a loss in 2009 and some in 2008. 2010 looks to be breakeven at best for many companies. These profitability trends are challenging for banks given that we have to maintain higher levels of capital in order to carry watchlist loans. In other words, banks must have higher levels of capital in order to continue to bank existing credits that have had poor performance or in order to entertain new loans to companies coming off of poor performance.

In order to compensate for poor performance in previous years, BBVA Compass is placing more emphasis on strong sponsorship, higher levels of equity in real estate or excess availability in borrowing bases. Underwriting the economic risk is more difficult and access to liquidity is important. Companies still in business in 2010 have probably weathered the worst and should be survivors. These borrowers are most likely creditworthy. Banks are now able to obtain appropriate pricing for market risk in deals.

While other parts of the country have experienced harsh economic conditions, Phoenix may be among the cities most impacted. Phoenix has to find a way to replace thousands of jobs lost due to the downturn in the real estate industry. Quite frankly, we need to bring new industry to Phoenix in order to propel job growth forward once again. The deficit state budget issues are further complicating, though, since we need to make business relocation to Phoenix more attractive.

III. Impact of TARP and the Current Regulatory Environment

BBVA Compass did not take TARP monies nor has our parent company taken any government assistance in Spain. BBVA Compass has received capital injected from our parent company which has enabled us to properly reserve while maintaining better than guidelines Tier I and Leverage ratios.

BBVA Compass and other banks need to continue the business of lending. We are beginning to see loan demand rise. Although it will not return to the high demand level of 2006 and 2007, it is beginning to rise as business owners are seeing slight economic improvement or least perceive that we have hit bottom in Phoenix. Requests for replacement equipment or owner occupied real estate given that values have been reset to more realistic levels are being made by borrowers. This is a good sign.

Therefore, we do need large, mid-size and community banks able to loan money. While I firmly believe that regulation is necessary and positive for banks, businesses and consumers, I also believe that in these unprecedented times, we need the ability to avoid the pitfalls of the past but manage out of where we are today. It is countercyclical and self-defeating to require additional capital when economic times are bad and less capital when economic times are good. Further, if bank's are properly reserved, this should be a full credit to the bank's capital soundness. In short, continued requirements for more capital will prevent many banks from loaning money to creditworthy businesses.

While this hearing is not about commercial real estate, the impact of commercial real estate in Phoenix and for Phoenix banks is critical to the ability of bank's to loan money to business owners. Many banks in Phoenix are beyond the current capital guidelines for commercial real estate and so much so that the ability to make business loans is impacted. Many banks are shrinking their overall balance sheets in order to come closer to the guidance. Unfortunately, in many cases, this means asking creditworthy borrowers to leave as these are the loans most easily placed at another bank. Also, if a bank has chosen to charge off a portion of a loan, in effect right size it to the income stream from the property, the remaining loan is classified and requires additional capital. If, however, a bank were able to treat the loan as restructured as a pass credit, capital requirements would be lower. All of these requirements serve to dampen lending in a time when we need to be expanding.

The non-regulated firms, ie mortgage brokers, investment firms etc., played a large role in the financial debacle we have experienced. On the other hand, banks for many years

have functioned in a regulatory environment. Most banks have their own internal audit and review teams that are at work providing oversight year round even when the regulatory bodies are not at their institution. We need to ensure that all firms able to loan money are under equal regulatory governance as the banks have been for many years. More regulation is not the answer but rather regulation for all in the lending business is the key to future soundness.

Chair WARREN. Thank you very much, Ms. Herndon. I want to make sure, as we start this, that we're taking a full picture. So I just want to focus, if I can for a minute, on the banks here.

How concerned are you about interest rate risk? I want to make sure we're getting the full picture here. Is it deterring you? Does it deter you from lending at current low rates? Are you concerned about that? Ms. Herndon?

Ms. HERNDON. Specifically rising interest rates?

Chair WARREN. Yes.

Ms. HERNDON. We certainly, when we underwrite loans, in particular, if they're going to be floating rate-based, apply a sensitivity analysis. In some cases, if we determine that a borrower would be rate-sensitive with, let's just say it's a 200 basis point rise in interest rate, we would probably encourage a borrower to go with a fixed rate which, in today's environment, the fixed rates that are being offered are certainly very good rates for small businesses.

So I think our path would be if we found a borrower to be interest rate-sensitive, we would encourage a fixed rate so that the borrower would not experience that.

Chair WARREN. Okay. I just want to be sure that I'm getting the picture. You're saying it doesn't discourage you from lending, it just has you—you manage for it?

Ms. HERNDON. That is correct. We manage for it.

Chair WARREN. Mr. Lundy.

Mr. LUNDY. I would agree with that. At this point in the cycle our bank is mildly liable sensitive and, you know, we certainly have entire programs in place to manage our interest rate sensitivity and it's one of the areas that I think the regulators do a good job of asking good questions and I don't believe that interest rate sensitivity in and of itself is a particular—it's not one of the major issues with respect to more lending.

Chair WARREN. And same answer, Ms. Wiest?

Ms. WIEST. It would be the same answer for my bank, but for banks in general, I think when you look at the overall risk profile of the bank, if the bank has a number of low fixed rates, certainly when you're concerned about rising interest rates and the sensitivity of your institution, there may be a change in the way the borrowers are financed.

You're not going to be able to just give everyone a lower rate and fix it for a period of time. I mean that's the reality.

Chair WARREN. You remind me with your answer, and I observed this as we were reading the testimony, we only have three banks in front of us, we may not have the banks we should be talking with. Superintendent Neiman noted we had to ask Wells Fargo to join us and they declined. There may be other banks we should be talking with, as well. But I just want to make sure I'm getting the picture.

The overall economy, the question about the overall economy, is this causing you to hold back on lending decisions, Mr. Lundy.

Mr. LUNDY. The overall economy is very difficult and so I think——

Chair WARREN. What's your overall outlook?

Mr. LUNDY. I think locally we are——

Chair WARREN. Your local and there's been a lot of trouble.

Mr. LUNDY [continuing]. Bumping along the bottom and we're somewhat encouraged that things have turned and will get slowly better, but it's not robust out there at all.

So, yes, sure, we're concerned about the economy and it does impact decisions we make and the decisions our prospective borrowers make.

Chair WARREN. Ms. Wiest, did you want to add anything on that?

Ms. WIEST. Yes. I'll just give you an example. I bought my home in 2006 when I moved here and I asked about the lot next door. They said it was $250,000. I just bought it a month ago for $30,000 from a bank. So we've got a ways to go here in Phoenix.

Chair WARREN. And is this—the question I have is how much it plays into lending decisions. Do you worry that the people you're lending to are not going to have business out there? I'm just concerned about this. I just want to understand how this factors in.

Ms. Herndon.

Ms. HERNDON. Well, I think clearly if you take a look at a business loan decision that we made three years ago, we didn't worry very much about the economy and the economic impacts. So it is certainly a larger factor in our decision, but we've also seen a lot of borrowers do all the right things last year, whether through looking at expenses, becoming more efficient, or preparing themselves from a balance sheet perspective to where we are.

So I don't think it's something that is deterring us from making loans to all borrowers in general.

Chair WARREN. Are you seeing any fallout at the level where you're lending from the loss of CIT and Advanta, shrinking trade credit, you know, the other places that people once went for credit? Let's talk about even smaller businesses. Credit cards, home equity lines of credit.

Are you seeing an impact from that? Ms. Wiest, you're shaking your head.

Ms. WIEST. Yes, absolutely, we are. I mean, I think what I saw that was interesting was I looked at a franchisee about a year ago and I saw them recently. They have 38 franchises, this guy that started a game truck thing, thought that was very interesting. I asked where they were getting their financing because typically it had been through traditional sources, credit cards, home equity, whatever. They are now—there is now a company out there that will actually take your 401(k), roll it into an entity where it becomes a self-directed 401(k) which allows you to buy stock in your company.

So, as a banker, I'm very concerned about the shadow banking system that's out there, but the fact that those kind of entities are gone, I think is forcing people to look at those types of vehicles.

Chair WARREN. Thank you. Mr. McWatters.

Mr. MCWATTERS. Thank you. Ms. Wiest, you mentioned this in your opening remarks, but I'm also looking at your testimony and I find this just extraordinary, that your financial institution has 39 percent Tier 1 capital and only 50 percent leverage. You have originated $25 million in loans and you still have $16 million of capital, but the punch line is that you say, "We could grow the bank by

$100 million in new assets and not need any new capital." That's extraordinary.

So you are ready to go. You're ready to lend money, is that correct?

Ms. WIEST. Well, it occurs to me I should have just come to these kind of hearings before to find customers instead of the way we were doing it.

Mr. MCWATTERS. Well, I mean, I was going to say Ms. Darling may want to talk to you afterwards. But you're ready to go. You have a $100 million and obviously you're out looking. You're beating the bushes. You're talking to people.

Why is this number here? Why aren't you telling me you only have $5 million of additional lending capacity?

Ms. WIEST. Well, first of all, as to the question of whether we want to loan, I can assure you we want to loan. We are only going to be profitable by wanting to loan, and I did, I think, in my testimony outline a lot of the reasons for that.

We have looked at a lot of credit, I mean a lot of credit, and I hear the frustration in the small business owners' voices and I think there is a perception out there that, in general, the banks aren't lending but there are, I think, a lot of banks like me who could and want to lend.

We don't have the distribution center necessarily to get out there. We don't have large advertising budgets. We depend upon our boards. We depend upon our community boards. So I think that's part of the issue, as well, is just getting the word out there that we are looking.

Having said that, I've spent 25 years in credit. I understand that, even though the person might be the best bet in the world, I'm not playing with my money. I'm playing with my shareholders' money and I have to make decisions based on fact.

Is there a secondary source of repayment? Just so you know, the comment about how we talk about credit, Paul and I have put together for the City of Goodyear some small business lending and one of the things I took in there was our loan policy with a grid that showed this is how much we'll advance on each type of credit, this is what you need to look like. So we're very transparent in that process.

Mr. MCWATTERS. Well, I noticed that Mr. Smiley went through five rejections. Then he went to you and you saw something in his business that five people passed by. Five opportunities were lost to other financial institutions.

What did you see?

Ms. WIEST. I liked a lot of things about his background. I liked the fact that he was an 8(a) lender. At my last bank I took two women from their kitchen tables to multistate companies and I understand the 8(a) process.

The flaw in the 8(a) process, though, is they put guys like Paul out there with this floodgate of work but no credit access. So they really need a working capital line that sort of dovetails to that.

Now the reason he had to leave my bank is we weren't qualified to do the Patriot Lines and it was the only way because he didn't have a historic proven record in this industry and again I have 10 employees. I basically could not really monitor the government con-

tracts correctly, but because he could get a Patriot loan, there was another bank that was able to take him to the next level. So I'm determined that doesn't happen in my bank again.

Mr. MCWATTERS. Okay. You submitted a TARP application and you withdrew your application and you say in your written testimony, "As our application was processing, we saw new conditions being added daily and witnessed the growing stigma being directed at TARP banks. Because we did not want to enter into an agreement with the Government who could alter the terms at any time, we chose to withdraw our application."

I mean that speaks for itself. I mean, do you have anything to add?

Ms. WIEST. No. The risk was greater than the reward of the amount of TARP money we would have been eligible for.

Mr. MCWATTERS. Okay. Do you have a slightly different feeling on the SBLF, Small Business Lending Fund, which may or may not become law?

Ms. WIEST. You know, I heard Mr. Ivie say that the banks will take that. I will only take it if it's clearly defined, if the process to get the money is very transparent, if it doesn't just flow through regulatory agencies, and if there is a measurement, I mean, because I think the public deserves that.

If you take the government money, you've got to be able to prove that you put it back for the purpose as intended. You heard Jim Lundy say that they took TARP money and they grew their bank and I think that's admirable and I think in his case, the TARP money worked.

I've got to know the process has a lot of transparency.

Mr. MCWATTERS. Thank you.

Chair WARREN. Thank you. Mr. Silvers.

Mr. SILVERS. Thank you. Well, first, let me say how grateful I am to all of you for being here.

The point of our holding field hearings is to hear from people like yourselves with businesses like yours. That very specific detailed experiential voice often doesn't come through in Washington.

Let me begin. Let me ask the small business people on the panel. I'm not sure it's clear from all of our statements and so forth, but there are really kind of three policy choices facing the Treasury Department in using TARP money to try to help small business and we're trying to oversee those choices.

Choice one is, and I think perhaps Mr. McWatters sort of stated it, is basically don't do anything, don't try to change the market incentives and structures and so forth. Don't put any money in.

Choice two is to give money to banks. That's essentially the SBLF proposal. Give money to banks, perhaps with some conditions and hope and try to manage it so that the money flows through from banks and small businesses.

Choice three is something along the lines of what Superintendent Neiman said earlier, which is to try to create specialized vehicles that will do small business lending only.

What advice would you have for the folks in Washington as to what to do?

Ms. ANDERSON. I'll leap on that one. I don't know that the do nothing else option is a viable option. The money's been out there.

It's been working as best it can with banks as best they can and they're not lending on their own criteria. We know that. They're not widely lending. They are lending some.

Giving the money to the banks for any of the programs, I would like to see transparency and a requirement that makes that happen, yet I'm also anti-involvement. We're a capitalistic society. I like to see the free economy flow.

I'm very, very intrigued by Mr. Neiman's proposal, having a consortium with specific requirements and taking a look at something that has worked in other areas, so that those that wouldn't necessarily get credit—start-ups, I've specialized in start-ups.

There isn't a banker in this room or probably within 10 miles of me that right now is interested in doing a start-up. The larger lenders have done that under the guise of some of the SBA preferred lender programs and other kinds of things but when you get right down to it, they're all preferring to go find the top 10 people in an industry and to collateralize and securitize as best they can.

So we do need an innovative idea, I think, that doesn't bind us for eternity into more government intervention and handouts. I love that consortium idea.

Mr. SMILEY. For six years I was an associate professor, a faculty member at Arizona State University School of Global Business, and at the national level in Washington, D.C., we hear about jobs, jobs, jobs. I tell you, there's not a day that goes by that my heart is not just pumped with gladness when I put someone back to work because I understand that people with jobs can now spend money at restaurants and other services. Those establishments now pay city and state taxes and that's how the economy works. It's not very difficult to understand.

When it comes to small business, as I mentioned in my testimony, there's this broad brush that some big banks use. They're not willing to listen to you. Every business is the same. Our business is totally different, you know. I thank God every day for the 30-some employees I have that they can have a home. They can go buy goods and services. They can send their kids to school. They pay taxes, which we all have to do and that's what makes the economy.

Since 2007, as I said in my testimony, we started with four employees. We now almost have 40 and that's amazing, but without people like Candace Wiest who sat down and said let me explain to you how lending works and she taught me about the five Cs of banking. From my perspective those five Cs of banking have been given the Heisman for small business and it's become very subjective lending versus objective lending, and I'm not going to send a small business colleague of mine to any bank whose balance sheets aren't correct, they don't have a stable business, they don't have a stable infrastructure.

So the small banks understand that, but when the big banks don't listen to you and they don't return a phone call or they tell you as a preferred lender that the SBA turned you down, which is not a true statement, you know, people give up. I've had four or five colleagues of mine in the last year say I give up, I give up, I give up because they can't get capital, access to capital.

At Sonoran, we're a good news story, but we will only continue to be a good news story if the small banks and the large banks start to listen to us, understand what we do and then give us a fair shake. Are you a risk? Are you creditworthy? Just give me a straight answer. I'll grow my business and I'll grow this economy, and just think, if every small business in Arizona hired 10 people, where would we be on the national perspective of putting people back to work and fixing our state budget and our city budgets and our county budgets.

This is not rocket science. It's about doing the right thing, having regulatory oversight, but giving everyone a fair shake to make the American reality, not the American dream.

Chair WARREN. If you'll bear with us, Superintendent Neiman, why don't we let Ms. Darling have an opportunity to respond, as well, since we've asked the small business owners?

Ms. Darling.

Ms. DARLING. Thank you. Just quickly, I agree with Ms. Anderson and Mr. Smiley. To do nothing would be terrible and what we need is more transparency, definitely, because we were turned down by a lot of banks, but I don't think that ever went on the books. I don't think you see the data because those banks never told us our loans were denied. They just went silent.

It was very difficult. Sometimes I would wait four to six weeks and the banker wouldn't call me, the banker wouldn't answer my questions. So I never knew whether or not my loan would go through.

So we do need to have respect. We do need to have different criteria that include service-based industries that don't have as many assets. We also have a tax issue where we accelerate depreciation 50 percent the first year. We buy a $150,000 laser scanner. We write-off $75,000. The banks look at it like it's a loss. It is nonsensical. So I'm going to be very happy to see some changes.

Chair WARREN. Thank you. Superintendent Neiman.

Mr. NEIMAN. Thank you. This is probably our first experiment in having a panel, to my memory, where we mixed bankers and borrowers, and you see we've actually interspersed the bankers. So maybe we can play our little role in hooking up creditworthy borrowers with bankers.

But I do want to follow up on the concept of a consortium and if TARP funds could be directed to banks but, in addition to utilizing those funds to leverage and to lend directly, could also use those funds to either invest in equity or to extend credit to a lending consortium.

Would that be of appeal? I'd like to get the bankers' perspective, if that would be a legitimate and viable use of those funds.

Mr. Lundy, I know Arizona has the concept of a banker's bank. We talked earlier that banker's banks do not actually do direct lending, but is that something that, in your understanding, could be developed and would it be a legitimate use—a viable use—of additional TARP funds?

Mr. LUNDY. My honest answer is I would be concerned that it could not be developed quickly enough in the short run. I think it's a good long-term idea.

Arizona does have what's called a multi-bank. It's been around for a long time and it's basically a similar vehicle to what you've described that focuses on making community development loans and CRA loans, and some of the larger banks invest money in it and it in turn makes loans.

I believe, as I said in my testimony, that the SBA programs generally work pretty well and I would like to see some more support. I would support the suggestions that the director made to perhaps expand the size of those loans up to five million. It might address some of the issues that Mr. Silvers raised.

Frankly, Mr. Neiman, I think it's a good idea, and I don't know how long it would take to get it set up, but in terms of the immediate solution, I'm not so sure it would have a great impact in the next year or year and a half. It's something to put in the hopper for down the road. That's my opinion.

Mr. NEIMAN. Ms. Wiest.

Ms. WIEST. I worked in California for 18 years prior to coming here and the state had a program there that was really terrific. It was strictly for working capital, no real estate, and they would guarantee up to 75 percent of a loan, a term loan, because so many of the small businesses do need permanent working capital. So they're not going to keep being able to escalate accounts receivable lines.

These guys would come in. They had a committee of regional bankers that looked at the loan requests and then they would guarantee 75 percent based on the covenants we put to monitor. I participated in that program for probably, I think, 12 years and I never had a loss and so while I like the idea of your program, there is also another solution, which would be to maybe have a state fund used for the purpose of guaranteeing smaller business loans. These would be $350,000 or under. So that might be another solution to think about because that was a very successful program in California for a long period of time.

Mr. NEIMAN. Another appeal I think a consortium bank would have, particularly to a bank of your size where you don't have necessarily the expertise necessary to focus in a new area, whether it be franchisee loans where a consortium could develop that.

Ms. Herndon, any thoughts?

Ms. HERNDON. I think my comments are similar. I think the multi-bank concept that already exists in Phoenix has worked. Obviously, I think they would love to have access to more capital to be able to participate in more lending opportunities.

I also think that the SBA has played a great role, even in good times the SBA was very active, but right now more than ever with borrowers being more capital distressed than previously.

I think having expansion, in particular the permanent working capital, the working capital line of credit programs, offered would be another way to stimulate loan growth.

Mr. NEIMAN. Great. Thank you. Ms. Wiest, you talked about your reluctance to enter the TARP due to the stigma.

Mr. Lundy, you were successful in taking it. What's your view on this concept of stigma? You seem to have weathered the storm and it hasn't seemed to have had a negative impact on you. Is that a correct way to assess?

Mr. LUNDY. Well, I think, early on it was sort of a batch of worthiness but we weren't one of the top 20 banks that posed systemic risk or anything of the kind.

But the fact that we were able to qualify for it was sort of an endorsement. The Government believes that we're not going to fail and so I think that was helpful and, frankly, the capital itself was helpful. But I would agree that from a public perception standpoint and for how capital actually works in a bank and that at the end of the day all funds are fungible and that's one of, I think, the—we don't have time to talk about that today, but that's one of the problems that makes accountability and tracing it difficult.

So I do agree there is a stigma. We were successful, but I would not rule out—as I said in my testimony, I think if Congress is going to do something, it should be done fairly quickly. So, on balance, I support the program.

Chair WARREN. I'm going to just ask a few more. I'd like to ask the business owners about your experiences with the SBA. We've been hearing about the banks' experiences with the SBA and maybe you could say just a bit more.

Mr. Smiley, you're pulling the mic over like you're ready to go.

Mr. SMILEY. Yes. I have colleagues all over the United States and there are various SBA offices here and I'm here to tell you that the Phoenix office is absolutely outstanding. They have monthly meetings. If you don't have information about the Small Business Administration, then you live under a rock. They do great work with workshops, with SCORE, outreach to the community. They were in Goodyear last fall and so Mr. Blaney and his staff—you know, they're undermanned. I think their office was probably reduced by about 40 percent the last couple of years, you know. I tip my hat to them. They do outstanding work.

Chair WARREN. Okay. Thank you, Mr. Smiley. Ms. Darling.

Ms. DARLING. Well, we went to SBA. We got a list of lending institutions. We went to each one of those institutions. We were turned down because we didn't have the assets, partly because we utilize an accelerated depreciation schedule of assets for tax purposes. The other reason was because we don't own commercial real estate.

Chair WARREN. So your concern about SBA lending is that you're saying it's really far more asset-based than it is alleged to be?

Ms. DARLING. Yes, for service industries.

Chair WARREN. Ms. Anderson.

Ms. ANDERSON. Yes, that's my experience, as well. The sba.gov website is amazing. There's all kinds of great information out there. The control and power is definitely within the individual lenders, the individual bankers, and the reason that you see community and regional banks here today is because these are the people that are lending. These are the people that are in the community. These are the people that are—it is a relationship-based business and the SBA loans are a minuscule number of the loans that are out there.

The 90 percent guarantee definitely helped, but the stories that you've heard from the two of them and in my testimony—I've given you a story, also, of some of my clients and I could go on and on with many of them where they're in the exact same situation. Peo-

ple have been bankrupted because they've not been advised that that loan that they got a letter of credit for, a letter of intent for actually went through.

It's the terminology. It's the devil is in the details, you know, not understanding what those criteria are. For example, a lender will look at a loan package and the business plan and we coach our clients through this whole process and they might be looking at a hair salon and they might compare the industry ratios to a different kind of salon that isn't a booth rental and it isn't a med spa and it isn't whatever and so they've got two or three reasons why they don't want to do this loan from the get-go. It's a start-up. It's whatever it is. It's going to be too small. They don't like the location. The person has never owned a successful chain of salons before, whatever that elusive criteria is, and the criteria needs to be made plain. The SBA can help with that.

Chair WARREN. Thanks very much. Mr. McWatters.

Mr. MCWATTERS. Thank you. That was pretty much my question, but I noticed in Ms. Darling's testimony that she makes the point that there's a lot of real estate lending that's been going on in Phoenix for the last several years.

Now all of a sudden that's stopped or at least it's slowed down. So you take a business like hers which is a cash flow business which is based off of earnings before interest, taxes, depreciation, amortization-type standard, and she's running into bankers who don't really know how to lend against that credit.

I mean, I lived in Dallas during the S&L crisis. We knew how to loan against real estate but once it blew up, it was a different story.

So the bankers on the panel, are you lending against cash flow now, is it changing, or are you still looking at real estate transactions?

Ms. WIEST. Well, you're looking at me, so I'll go first here, but two things.

Number one. Yes, we are lending and it really isn't that difficult if you understand cash flow lending in general, whether it's real estate or C&I loans, whatever, and I think the banks have better models. I survived the recession in 1988 over here and 1991 in California. So there are plenty of models out there who help you do it better.

I also think the interesting part is, we were talking about the SBA, we've done three SBA loans, 504s, for small business owners to be able to take advantage of this rotten real estate market. So that is going on out there, but we are lending on accounts receivable. Government receivables are difficult. You've really got to have a staff that could get in there and control your collateral is the problem.

So I think if you asked any regulatory body, they would tell you that you can't just have a primary source of repayment be we're going to collect these receivables. There has to be some secondary source of repayment because stuff happens.

Mr. LUNDY. I would agree with that. I mean, the whole banking model—the community bankers here aren't investment banks. We don't get entrepreneurial return. We rent money, and we need to have two ways out and the first way out, we can all agree on, the

business is going to make money and that cash flow is going to pay the loan off and if it doesn't, we need some other source of money, whether it's personal guarantees that have something behind them, whether it's a lien on real estate, residential or commercial, and obviously those two things have been impacted. The values have been impacted.

Sometimes the second way out, because the nature of the business and the collateral is somewhat specialized, that's where I think the SBA and that guarantee can come in. Everything else makes sense, but there's sort of a hole because of perhaps the intangible nature of the assets, but at the end of the day, bankers rent money. We lend our shareholders' money and the depositors' money that are FDIC-insured and we cannot take entrepreneurial risk, and I think there's a disconnect sometimes between that reality and the borrowing public, but it is a reality.

Chair WARREN. Mr. Silvers.

Mr. SILVERS. Thank you. Ms. Wiest, where is the money that you are not lending out invested in?

Ms. WIEST. Actually, we have some in securities where we are earning a whopping three to four percent and we have right now about $3 million in overnight funds where we are earning .25 percent.

Mr. SILVERS. When you say—I mean, obviously without getting into specific names, when you say securities, what——

Ms. WIEST. Mortgage-backed. I had one corporate which we sold recently, but, yes, mortgage-backed securities.

Mr. SILVERS. Thank you. Mr. Lundy, you said a few moments ago in response, I think, to Superintendent Neiman's question that you thought one of the major issues around TARP and the declining prestige of being a TARP recipient was that money's fungible and it was very difficult for there to be any accountability in the capital purchase program as to what the money was really being used for.

That strikes me as, in relation to any further TARP activity around small business lending, that you'd want to silo it, that you'd want to be sure it was really going to small business and small business only. Am I hearing you right?

Mr. LUNDY. Well, I think to get the accountability that you talked about, some mechanism to do that would be—from a policy standpoint—if Congress decides to do this and this is a specific result that you want, I believe that some sort of segregation or accountability of that nature would be ideal, but it is difficult.

Capital ratios are capital ratios and you asked her what her excess liquidity is invested in. We've now got about $240 million in AAA mortgage-backed, Ginnie Mae, et cetera, securities and, unfortunately, about $275 million in overnight at 25 basis points.

So we do need to put money out and we are putting money out, but it's difficult.

Mr. SILVERS. I should just note a moment of self-congratulations to us that we've been calling for some accountability around how the TARP money was used within banks since, I think it is, December of 2008. That's the nature of an advisory oversight panel.

Ms. Herndon, in your written testimony you talked about the fact that your bank is an affiliate of a large Spanish institution that I gather is fairly healthy as large institutions go these days.

Can you observe, and I'd welcome any other panelists to observe, really this question of capital strength. You know, each of you, because of your affiliates, because of capital raises, each of you are pretty strong in terms of capital.

When you look across the banking sector as a whole, the large institutions that dominate the deposits in Phoenix, and other small institutions, have we sort of picked out all the outliers to have with us here today and what conclusions can we draw about that, about the question of capital strength in relation to small- and medium-sized business lending?

Ms. HERNDON. Well, I actually think it compares the same when you talk about borrowers in general. I mean, clearly a lot of what borrowers are finding is their excess liquidity, their excess capital that they had maybe heading into these times has been diminished because they've had to use it.

Again, because of the strength of our parent, they were able to inject capital for us so that we could continue to loan money. Had we not been acquired by them two years ago, we would have had a much larger percentage of real estate unable to be offset, if you will, by the overall portfolio of the bank. So it's clearly been an added benefit for us.

But I do think that there are many banks in Phoenix that are strong that do want to loan money but are struggling to sort of get around the whole issue of the capital constraints, dealing with a lot of the issues that we've been talking about today, either the existing risk in the portfolio or the pending risks that might be coming from reappraisal due to real estate.

I mean, no banks here have been able to escape the impact of the real estate market.

Ms. WARREN. Superintendent Neiman.

Mr. NEIMAN. Mr. Lundy, a follow-up on your question about transparency, and we all acknowledge that money is fungible and when capital goes in how that's converted to loans.

But can you identify loans that would not have been made but for the receipt of that $35 million that came through the TARP Fund?

Mr. LUNDY. Well, consistent with my comment, not specifically, no, but I can tell you that, as I said in my written testimony,——

Mr. NEIMAN. There were loans that were made but——

Mr. LUNDY. Well, sure. We made—we grew loans.

Mr. NEIMAN. But only the result of——

Mr. LUNDY. $66 million last year. We've grown loans $34 million in the first quarter. That's a $100 million in loans. That's pretty good loan growth for our banks.

Mr. NEIMAN. Loans that would not have been made but for the TARP?

Mr. LUNDY. Yes, and if we—well, let's just put it this way. Well-capitalized basic capital is 5 percent. You know, you can get a lot of conversation. Is eight the new five or is eight the new six, but there is, from every direction, pressure on capital and we're maintaining 6 percent leverage capital.

Were we not doing that, we would not have felt comfortable growing and expanding the balance sheet to the extent that we

have on both loans and deposits. So indirectly it has had a positive effect.

Mr. NEIMAN. I want to ask the borrowers and maybe even the bankers, since the large banks are not here, I'd like to understand from the small businesses, do you see discernible differences in underwriting standards or dealing with you in the application process?

Ms. ANDERSON. Absolutely. Night and day, an absolute night and day difference. The smaller banks spend the time to shoulder to shoulder—start out with like a 15-to-20-minute quick back of the napkin, here's what needs to happen, here's what I don't like about your financials, here's what I don't like about your package, and they really befriend that borrower nine times out of 10 in a way that the large lender does not do.

The loan application goes off into the abyss of an application center in Houston somewhere and it's lost. Arguing the merits of the loan package for the borrower or their financial condition is much more successful in a relationship-based application than it is in a larger bureaucracy.

Mr. NEIMAN. And maybe from the bankers' perspective, now in the role of competitors, are you seeing differences in competing against those three largest institutions that comprise 70 percent of the deposits?

Mr. LUNDY. Well, a couple of things. I think Mr. Silvers' point earlier is worthy of everyone's note. Didn't you say that, in 1999, 15 percent of these loans were made and then, by 2008 or something, before the great abyss, 38 percent or something were made by large national institutions and that's basically been the trend about the last 15 years. Increasingly smaller business loans because of the economies of scale are underwritten essentially as consumer loans with credit scoring models.

I think this recent huge recession has surprised everybody's models. So, there are industry dynamics that have forced—you know, I mean, we're dealing with what we're dealing with and it took 20 years to do it and so now the more hands-on relationship approach that I think is a friendlier way to do it, I mean, if you're really going to get that to happen, you have to have community bankers who are willing to meet with people one on one, but it's difficult.

Chair WARREN. I want to thank you all very much. We really appreciate your coming and spending your time here with us today.

We also appreciate your giving us your written testimony. We will make sure that everything that you've submitted to us will be made part of the record for this hearing. So this panel is also dismissed. Thank you, again. We really appreciate it.

If there are members of the public who would like to make any comments, we have a microphone set up. We keep them brief but people are welcome to, if they want. Seeing no one rushing to the microphone, I am going to assume then that we have concluded our business.

Again, thanks to the University of Arizona, thanks to the senators and congressmen here from Arizona. We appreciate all their help so that we could come here in order to learn more about small business lending. What we've learned today will very much help us in this process.

Thank you all.
[Whereupon, at 12:05 p.m., the meeting was adjourned.]